



Fiduciary Responsibilities under ERISA

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Fiduciary Responsibility Rules

- Employee Retirement Income Security Act of 1974, as amended (“ERISA”), governs “employee welfare benefit plans” and “employee pension benefit plans” sponsored by employers, including
 - Retirement Plans
 - Defined Contribution (401(k), profit-sharing, ESOP, etc.)
 - Defined Benefit (traditional pension, cash balance, etc.)
 - Welfare Plans
 - Group medical, dental, and vision plans
 - Life insurance, disability, and accident insurance
 - Other (e.g. employee assistance program)

ERISA § 3(1) and (2)

ERISA Fiduciary Structure

- Every plan must have one or more “named fiduciaries.”
 - Named fiduciaries have authority to control and manage plan operations and administration
 - Can be a person or entity
 - Can be named in plan or selected under plan procedures
 - Can be identified by position or name
 - For most plans, it is the employer (=plan administrator) or administrative committee
 - Generally advisable not to name an individual

ERISA § 3(16)(A); 402(a)(1); 403(a)

ERISA Fiduciary Structure cont'd

- Every plan has a plan administrator (separate from any third-party administrator).
 - Automatically a fiduciary
 - Individual, position/title, or entity named in plan document
 - If no designation in plan, then plan administrator is the employer
 - Again, generally advisable not to list an individual
- The assets of a retirement plan generally must be held in trust by one or more trustees (subject to certain exceptions).

ERISA § 3(16)(A); 402(a)(1); 403(a)

ERISA Fiduciary Structure cont'd

- The assets of a retirement plan generally must be held in trust by one or more trustees (subject to certain exceptions).
 - May be an individual, group of individuals, or institution
 - Always a fiduciary under ERISA
 - Trustees may be
 - Discretionary (with responsibility for investing and managing assets)
 - Directed (with responsibility more limited to holding, protecting, and preserving plan assets in the trust)

ERISA § 3(16)(A); 402(a)(1); 403(a)

ERISA Fiduciary Structure cont'd

- A named fiduciary may employ persons to render advice regarding fiduciary responsibilities.
- A named fiduciary with respect to control or management of plan assets may appoint an investment manager.

ERISA § 402(c)

Definition of a Section 3(21) Fiduciary

- Any person who exercises any discretionary authority or control over the management or administration of the plan;
- Any person who exercises any authority or control over the management or disposition of the plan's assets; or
- Any person who renders advice for a fee with respect to any of the plan's assets (e.g., a registered investment advisor).

ERISA § 3(21)(A)

Definition of a Section 3(38) Fiduciary

- Limited to an “investment manager” who
 - has the power to manage, acquire, or dispose of any asset of a plan;
 - is registered as an investment adviser (under the Investment Advisers Act of 1940 or applicable state laws) or is a bank; and
 - has acknowledged in writing that he is a fiduciary with respect to the plan.
 - 3(21) v. 3(38)

ERISA § 3(38)

Ministerial Duties

- Performance of ministerial tasks not a fiduciary function
 - applying rules to determine eligibility;
 - calculating service or compensation credit for benefits;
 - preparing employee communications materials;
 - maintaining participant service records;
 - preparing government agency reports;
 - calculating benefits;
 - orienting new participants;
 - collecting and transmitting contributions;
 - processing claims; and
 - making recommendations about plan administration.
- But authority over benefit determinations is a fiduciary function

ERISA § § 3(16), 402(a)(1), 403(a)

Fiduciaries or Non-Fiduciaries?

- Plan Administrator assisted by:
 - Administrative Committee
 - Appeals Committee
 - Investment Committee
 - Others

- Named Fiduciary(ies)

- Third-Party Administrator
 - Discretionary authority (e.g., final authority to decide claims)
 - No discretionary authority (note: contract not dispositive)

ERISA § § 3(16), 402(a)(1), 403(a)

Fiduciaries or Non-Fiduciaries? cont'd

- Trustee
- Investment Manager
- Investment Advisors
- Other Advisors (Accountants, Attorneys, etc.)
- Directors
- Officers
- Employees

Fiduciary Duties Under ERISA



- Overview
 - ERISA fiduciary standards: among the highest known in the law
 - ERISA rules are intentionally broad and functional (if you act like a fiduciary, you are a fiduciary)
 - ERISA fiduciary responsibilities apply to all actions taken as a fiduciary
 - Certain transaction are prohibited per se
 - ERISA fiduciaries can be personally liable for losses to an ERISA plan

ERISA § 404

Fiduciary Duties cont'd

- 4 Fiduciary Rules/Requirements:
 - Exclusive Benefit Rule
 - Prudent Man [Expert] Rule
 - Duty to Diversify
 - Duty to Follow Plan Document

ERISA § 404(a)(1)

Fiduciary Duties cont'd

- Exclusive Benefit Rule (Duty of Loyalty)
 - Fiduciaries must discharge their duties with respect to an employee benefit plan
 - solely in the interest of its participants and beneficiaries and
 - for the exclusive purpose of
 - (i) providing benefits to participants and beneficiaries, and
 - (ii) defraying reasonable expenses of administering the plan.

ERISA § 404(a)(1)(A)

Fiduciary Duties cont'd

- Prudent Man [Expert] Rule
 - Duties must be discharged 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.
 - Complex, multi-part rule.

ERISA § 404(a)(1)(B)

Fiduciary Duties cont'd

- Prudent Man [Expert] Rule
 - Duties must be discharged with the
 - care,
 - skill,
 - prudence, and
 - diligence
 - under the circumstances then prevailing
 - that a prudent man [person]
 - 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.

ERISA § 404(a)(1)(B)

Fiduciary Duties cont'd

- Duty to Diversify
 - Fiduciaries responsible for plan investments must diversify such investments so as to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so.
 - Limited application to participant-directed plans (e.g., 401(k) plan).

ERISA § 404(a)(1)(C), 404(a)(2)

Fiduciary Duties cont'd

- In Accordance with the Document Rule
 - All fiduciary duties must be discharged in accordance with the documents and instruments governing the plan insofar as they are consistent with ERISA.
 - Review plan documents.

ERISA § 404(a)(1)(D)

One Other Important Duty: Avoid “Prohibited Transactions”

- “Parties-in-Interest” versus “Disqualified Persons”
 - Service providers, affiliates, employer, employees, family members
- “Per se” Prohibited Transactions (PTs) - Direct or Indirect:
 - Sale, exchange or leasing of property;
 - Lending of money or extension of credit;
 - Furnishing of goods, services, or facilities;
 - Transfer to or use of plan assets; or
 - Acquisition of any employer security or real property in violation of ERISA § 407(a)

ERISA § § 3(14),
406(a), 407(a), 407(d)(5)
Code § § 4975(c)(1), (e)(2)

Prohibited Transactions cont'd

- “Self-dealing” prohibited transactions: between a fiduciary and a plan that involves plan assets
 - Self-dealing
 - Conflicts of interest
 - Anti-kickbacks

ERISA § 406(b)

Prohibited Transactions cont'd

- Exemptions from prohibited transaction rules
 - Service provider exemption
 - Loans to participants
 - Broker-dealer exemption
 - Qualified Professional Asset Managers (QPAM)
 - In-house Asset Managers (INHAM)
 - Blind Transactions on Exchanges
 - Agency Transactions and Cross Trades
 - Acquisitions of Asset-Backed Securities
 - Block Trades
 - Securities Lending

ERISA § 408(b)

Prohibited Transactions cont'd

- Service provider exemption: three requirements
 1. Services provided pursuant to a contract or reasonable arrangement
 - At a minimum, must permit termination on short notice without penalty
 2. Services are necessary for operation of the plan
 - Services are helpful to the plan in carrying out the purposes for which it is established or maintained
 - Expenses for settlor functions are not necessary for the operation of the plan

Prohibited Transactions cont'd

- Service provider exemption cont'd
 3. No more than reasonable compensation is paid for the services.
 - Compensation not reasonable unless service provider makes annual and quarterly written disclosures of fees it receives and the services it performs
- Service provider exemption DOES NOT apply to a “self-dealing” prohibited transaction by a fiduciary (ERISA 406(b)).

ERISA § 408(b); DOL Reg. § 2550.408b-2.

Common Fiduciary Functions

- Fiduciary functions generally fall into one of these categories:
 - Hiring service providers
 - Monitoring service providers
 - Managing plan assets
 - Informing participants and beneficiaries

Common Fiduciary Functions cont'd

- Hiring a service provider
 - Seek information from multiple providers (RFI/RFP)
 - Compare firms based on same information
 - Obtain information about firm itself (experience, financial stability, etc.)
 - Evaluate quality of services
 - Check licenses
 - Check complaints (e.g. FINRA BrokerCheck)
 - Document the process!

Common fiduciary functions cont'd

- Monitoring a service provider
 - Review performance
 - Read reports
 - Fees, fees, fees
 - Ask about policies and practices (e.g., claims processing)
 - Ensure records are properly maintained
 - Check claims procedures compliance
 - Follow up on complaints
 - Document the process!

Common fiduciary functions cont'd

- Managing plan assets
 - If outsourcing, oversee the managers
 - For retirement plans
 - Review fees regularly
 - Benchmark
 - For welfare plans
 - Employee contributions may be “plan assets”
 - Must deposit or forward to insurer in timely manner
 - Rebates from insurers (MLRs) may be plan assets
 - Document the process!

Common fiduciary functions cont'd

- Informing participants and beneficiaries
 - Provide SPDs and SMMs
 - Provide annual and quarterly notices
 - Summary Annual Report (SAR)
 - Summary of Benefits & Coverage (SBC)
 - Individual Benefit Statement
 - Provide special notices
 - Blackout period
 - COBRA
 - HIPAA

Types of Plans

- Health Care Flexible Spending Accounts
 - Welfare benefit plans
 - Must have a named fiduciary and plan administrator
 - Service provider (e.g., a third-party administrator (TPA)) may be a fiduciary depending on service provided.
 - Service provider not necessarily fiduciary when it provides services to a plan (e.g., processing claims, applying eligibility rules, preparing communications, preparing government reports, calculating benefits, and making recommendations).

Types of Plans

- Health Care Flexible Spending Accounts (continued)
 - Service provider (e.g., a third-party administrator (TPA)) may be a fiduciary depending on service provided.
 - Will be fiduciaries to the extent that they have discretionary authority or control over plan administration or exercise authority or control over plan assets.
 - Service provider will be a fiduciary based on the actual functions that it performs, regardless of what the contract provides.

Types of Plans

- Group Health Plans and COBRA
 - COBRA participants can bring breach of fiduciary claims
 - May seek “appropriate equity relief” (not monetary damages)
 - May target employer as plan administrator
 - May target insurers and third-party administrators (TPAs)
 - Depends on whether they have discretionary authority
 - Possible fiduciary duty to notify qualified beneficiaries of adverse consequences (*Bowerman v. Wal-Mart Stores*)
 - Possible fiduciary duty to investigate existence of COBRA rights (*Swift v. Protective Life Ins. Co.*)

Types of Plans

- Health Care Reform (Affordable Care Act)
 - \$1,000 per failure (adjusted for inflation) penalty for willful failure to provide Summary of Benefits and Coverage (SBC)
 - But affected individuals could also sue for breach of fiduciary duty

Types of Plans

- HIPAA
 - HIPAA has no specific private cause of action for violation of administrative simplification rules
 - However, to the extent provisions are in plan document, fiduciaries have a duty to administer in accordance with the plan terms
 - Participant could bring breach of fiduciary duty claim (e.g., plan discloses protected health information in violation of HIPAA)

Impact of “Fiduciary Rule”

- Currently delayed through June 9, 2017
 - Still uncertain if or when rule will become effective
- Expands definition of “fiduciary” to include financial services industry
 - Must act in bests interests of participants without regard to commissions or fees
 - Replaces lower “suitability standard”
 - Advisors argue this will curb willingness to provide advice

Impact of “Fiduciary Rule” cont’d

- BICE: Best Interest Contract Exemption
 - Description of material conflicts
 - Disclosure of fees
 - Statement of third-party compensation
 - Disclosure of omissions, revenue sharing, 12b-1 fees
- Education Carve-Out
 - General education is not advice
- Sales Pitch Exception
 - Presumed to not be impartial
 - Only applies to plans with at least \$50M in assets

Impact of “Fiduciary Rule” cont’d

- If the rule becomes effective, it will affect relationship with service providers
 - Changes to service agreements may be needed
 - Rollover recommendations
 - Rollover to IRA direction is fiduciary act
 - May reduce rate of rollovers to IRAs
 - Sponsors can expect to have fiduciary duty to ensure advisors follow the rule
 - May curtail no-cost investment advice to participants in plan

Liability for Breach of Fiduciary Duty

- Losses and restoration of profits resulting from a breach of duty
 - Personal liability
- Civil penalties
- Criminal penalties
- Co-fiduciary liability – when aware of a knowing breach by another fiduciary
- Excise taxes – when the fiduciary is directly involved with a prohibited transaction

ERISA § § 405, 409, 502(l);
Code § 4975(a)

Plan Fiduciary Checklist

- Understand fiduciary responsibilities
- Understand the plan document
- Understand the fiduciary structure (who's who?)
- Understand plan procedures
- Understand indemnification, insurance, and bonding requirements
- Seek advice as needed (prudent expert)

Recent Cases

- Suits targeting retirement plan fees
 - Fund expense ratios
 - Retail versus institutional
 - Lowest share class/no revenue sharing
 - Active versus passive mutual funds
 - Stable value versus mutual funds
 - Collective trusts and separate accounts
 - Recordkeeper fees and RFPs
 - Failure to use bargaining power
 - Too many investment options
 - Use of proprietary funds
 - Significant change in fund lineup? There must have been a problem before!

Recent Cases cont'd

- Also
 - Proprietary fund cases
 - 403(b) plans
 - Smaller plans targeted
 - Employer stock cases

Notable Fee Suits

- Honda – **\$15 million**
- BB&T
- Deere & Co.
- Lockheed Martin – **\$62 million***
- International Paper – **\$30 million**
- Boeing – **\$57 million**
- Kraft – **\$11 million**
- General Dynamics
- Caterpillar – **\$16.5 million**
- Anthem
- Walmart – **\$13.5 million**
- Bechtel Corp. – **\$18.5 million**
- Intel
- Oracle
- Chevron
- Delta Airlines
- Voya Financial
- Walt Disney Co.
- J.P. Morgan
- Charles Schwab
- Jackson National
- Bank of America
- Safeway
- J.C. Penney
- Starwood Hotels

***Bold** denotes reported settlement amounts

Johnson v. Delta Air Lines, Inc.



Summary

- Class-action suit filed against the company and its administrative committee on December 20, 2016.
- Claiming a breach of fiduciary duty regarding the company's 401(k) plan investment options.
- Provides a comprehensive listing of fee-related fiduciary claims.

Johnson v. Delta Air Lines, Inc. cont'd



Claims

- Company failed to provide lowest cost investment options
 - “if two investment options are essentially equivalent in all respects except that one has higher fees, offering the higher-fee option to Plan participants is careless at best and misleading at worst”
 - Company should have used its considerable bargaining power to negotiate lower fees

Johnson v. Delta Air Lines, Inc. cont'd



Claims cont'd

- Company offered too many investment options
 - “an overwhelming array of options”
 - Typical number is around 14—here there are over 200
 - Investment options are redundant
- Company failed to monitor investment options
 - As a result, it retained numerous poorly performing investments

Johnson v. Delta Air Lines, Inc. cont'd



Claims cont'd

- Company paid excessive amounts to the recordkeeper
 - Company should have used bargaining power to conduct bidding process
 - Company should have monitored fees carefully when agreeing to revenue sharing
 - Direct compensation to service providers of \$3.5 million plus estimated revenue sharing of around \$20 million was excessive

White v. Chevron



Summary

- Class-action suit brought against the company and its 401(k) plan administration committee
- Excessive fee-related claims similar to those brought in *Delta Air Lines*
- Court dismissed fiduciary duty claims because plaintiffs failed to establish the defendants breached the duty of prudence

White v. Chevron cont'd



Claims and Court's Response

- Stable-value fund should have been offered
 - Not required by ERISA or the plan
 - The actions of a fiduciary are judged based on information available to the fiduciary at the time of the decision
 - Decisions not reviewed “from the vantage point of hindsight”
 - Key is whether the fiduciaries employed proper methods to investigate the course of action when the decision was made

White v. Chevron cont'd



Claims and Court's Response cont'd

- Some funds had excessive management fees
 - ERISA does not require fiduciaries to “scour the market to find and offer the cheapest possible funds.”
 - Cost is not the only relevant consideration
 - No bright-line test
- Revenue sharing resulted in excess fees
 - No rule that revenue sharing is per se unreasonable
 - Revenue sharing can benefit participants

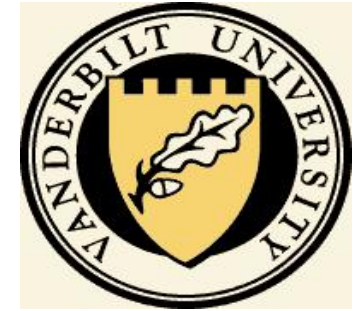
White v. Chevron cont'd



Claims and Court's Response cont'd

- Too slow in removing underperforming funds
 - More than poor performance is considered
 - Retaining a poor performer may be prudent decision for long-term investment strategy

Cassell v. Vanderbilt University



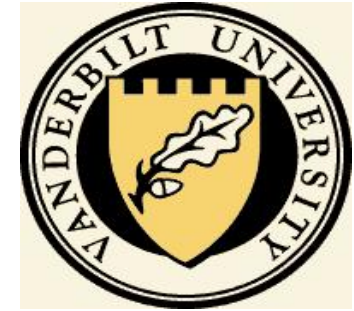
Summary

- One of a number of recent suits targeting university 403(b) plans
- Plaintiffs claim the university and plan administrators breached their fiduciary duty to prudently manage the plan

Claims

- Failed to use substantial bargaining power to demand lower administrative and investment management fees
- Too many recordkeepers (four)

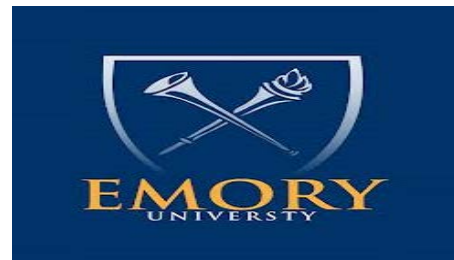
Cassell v. Vanderbilt University cont'd



Claims cont'd

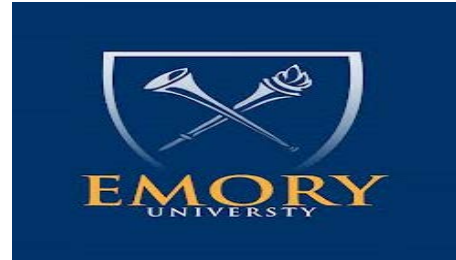
- Too many investment options (340)
- No competitive bidding process
- Significant changes in 2015 suggest there was a problem
 - University greatly reduced investment options and consolidated to one recordkeeper
 - Plaintiffs quoted from University handout explaining changes were being made to reduce expenses as an explicit admission that administration was flawed

Henderson v. Emory Univ.



- Proposed class action filed August 2016
- Allegations
 - Too many investment options (111)
 - Using higher cost retail share classes rather than lower cost institutional share classes
 - Using actively managed funds instead of passively managed funds
 - Charging excessive fees for recordkeeping and administration

Henderson v. Emory Univ.



- Usual breach of fiduciary duty claims
- Court refused to dismiss breach of fiduciary duty claims but rejected theory that offering too many funds could result in a breach (“Having too many options does not hurt the Plans’ participants, but instead provides them opportunities to choose the investments that they prefer.”)

Considerations for Fee Cases

- Whether investment options offered under the plan can be offered at a lower share class with a lower expense ratio;
- The advisability of undertaking a periodic “full due diligence review” of funds that have been selected for the plan; and
- Taking into consideration any “significant changes” or “changes in circumstance” that would warrant changing an investment option.

Key Takeaways for Fiduciaries

- Understand the 4 ERISA fiduciaries: exclusive purpose, prudence, diversification, and following the plan documents.
- Have a prudent process for administration and follow it.
- Understand the role of other fiduciaries.
- Monitor service providers.
- Benchmark performance.
- Regular requests for information (RFI) and request for proposal (RFP)
- Document the process!

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