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)
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 transactions 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

ERISA § 408(b); DOL Reg. § 2550.408b-2.
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!
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
- BB&T
- Deere & Co.
- Lockheed Martin – $62 million*
- International Paper – $30 million
- Boeing – $57 million
- Kraft – $11 million
- General Dynamics
- Caterpillar – $15 million
- Anthem
- Walmart – $16.5 million
- Bechtel Corp. – $13.5 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.
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
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
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
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
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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