DickinsonWright presents

ERISA Fiduciary Duty For Human Resources Professionals: Managing Risk and Implementing Best Practices

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Topics Covered

- Who is a Fiduciary?
- What are Fiduciary Duties?
- Basic Fiduciary Duties
- Prohibited Transactions
- Risks for Violating Fiduciary Duty
- Best Practices/Best Practices – Fees
- Fixing Problems
- Surviving a DOL Audit

Two Ways To Be A Fiduciary

- Named fiduciary – named in the plan document
- Functional fiduciary – exercises discretion or has control of plan assets

➢ *Note*: a person is a fiduciary "to the extent" that he or she exercises fiduciary functions.

Who Is A Fiduciary?

Under Section 3(21) of ERISA, a fiduciary is a person who:

•exercises discretionary authority or control in managing a plan or has authority or control over the management or disposition of plan assets;

•renders investment advice for a fee with respect to plan assets; or

•has discretionary authority or responsibility in administering a plan

Investment Fiduciaries

Two Functional Fiduciary Investment Models

•ERISA 3(21) Fiduciary
  - ➢ Sponsor/Committee receives investment advice from advisors but makes final decisions on funds and allocations

•ERISA 3(38) Fiduciary
  - ➢ Investment manager delegated authority for making final decisions on funds and allocations
  - ➢ Sponsor/Committee retains responsibility to monitor investment manager

Settlor Functions

- **"Settlor Functions"** = Business decisions, not fiduciary acts
  - ➢Establish, design, amend or terminate plan
  - ➢Decide plan contribution levels

- Employer can be fiduciary **and** settlor

Fiduciary Functions

- **Fiduciary Decision**s
- Establish investment policy
- Select investment options to be offered
- Select/remove service providers (investment manager or adviser, recordkeeper, TPA, auditor)
- Direct trustee and vote proxies

- Administer plan
- Establish committee rules
- Determine eligibility and amount of benefits
- Approve content of communications
- Appoint other fiduciaries
- Approve or deny claims

Basic Fiduciary Duties

Duty of Loyalty

- Complete and undivided loyaly to plan participants
- Must disregard interests of plan sponsor
- Give complete and accurate responses
  - <u>Example</u>: Higher 401(k) participant fees but lower fees for corporate services (payroll, NQDC admin)
  - <u>Example</u>: No brother-in-law rule

LOYALTY: PAYING EXPENSES FROM PLAN ASSETS

- Recordkeeping fees
- Fidelity bond premiums/PBGC premiums
- Legally required plan amendments
- Testing fees (ADP/ACP/Top Heavy/415)
- Audit fees
- Form 5500 preparation fees

. . . if necessary services, reasonable cost and allowed by the plan document.

MAY NOT USE PLAN ASSETS TO PAY FOR SETTLOR ACTIVITIES

Duty of Prudence

- Act as prudent expert
- Same care, skill, prudence and diligence under circumstances that prudent man familiar with like matters would use in similar circumstances
- Engage consultants if necessary
- Document procedure
- Ongoing obligation to monitor continued prudence of decisions

Duty to Diversify

- Diversify plan investments to minimize risk of large losses unless prudent not to do so
  - Reduce overall risk to plan by spreading investments over risk and return spectrum
- Consider investment objectives and cash-flow requirements

Duty of Compliance

- Must administer plan according to its written terms
  - ➢Only if written terms do not violate ERISA
  - ➢Plan terms must be consistently enforced
  - ➢No special deals not in plan

Prohibited Transactions

Fiduciary May Not:

•Allow plan to engage in transaction with person fiduciary knows or has reason to know is a party in interest/disqualified person

•Deal with plan assets for own interest

•Act in transaction with plan on behalf of party whose interests are adverse to plan or its participants/beneficiaries

•Receive personal payment in connection with transaction involving plan assets

•15% excise tax per violation per year until corrected

Risks Of Violating Fiduciary Duties

- Personal liability to make good losses to the plan
- DOL/IRS civil penalties and excise taxes
- Removal or barred from being a fiduciary
- Possible criminal penalties for willful violations

➢ Caution: Liable for acts of co-fiduciary, if errors known and no corrective action taken

➢ Caution: Increased DOL enforcement action and targeted audits

Best Practices

Identify or Appoint Internal Fiduciaries

- Who are current fiduciaries and how do you know?
- Align plan terms and actual practice
- (Re)Appoint one or more persons to be the fiduciary
  - Consider a committee that includes HR, finance, and operations but skill sets most important
  - Who has authority to appoint?
- Create papertrail - document the appointment
- Adopt a committee charter outlining roles and responsibilities

Best Practices

Fiduciary Meetings

- Have regular scheduled meetings (recommended at least quarterly)
- Circulate agenda ahead of time
- Appoint secretary to take notes and prepare minutes
- Bring in experts, as needed
- Declare a quorum
- Review action items from prior meeting

Best Practices

Documenting Meeting

- Consider your potential audience (e.g., DOL, Participants)
  - Demonstrate rational connection between issue to be decided, facts giving rise to issue, plan document language being interpreted, and conclusion reached
- Highlight Meeting Decisions and Action Items
- Detail Important
  - Qualitative comments by experts ("well constructed portfolio")
  - Recommendations by experts
  - Questions from Committee members and responses
  - Reasons for decisions tied to facts and recommendations

Best Practices

Selecting Service Providers

•Understand services provided and fees to be paid

•Understand how to terminate contract and any early termination fees

•Confirm service provider has adequate insurance

•Ask for and follow up on customer referrals

•Have ERISA attorney review the contract

– Governs your entire relationship with provider and they wrote the contract for their advantage

•Document reasons for retaining

Best Practices

Decision Making Process

•Is action prudent?

•Is the action in best interest of participants?

•Is there a conflict of interest?

•What does ERISA/Tax Code require?

•What does plan document provide?

•How have past similar situations been handled?

•Obtain advice from an ERISA attorney, investment advisor or other experts?

Best Practices

Educate Fiduciaries

•Conduct on-going training on fiduciary duties and responsibilities

➢ Mandatory training for new fiduciaries

•Regular updates on developments in laws and regulations

•Implement and follow a compliance calendar

Best Practices

Elect ERISA Section 404(c) Protection

•Fiduciary not liable for investment decisions of participants - if plan offers a broad range of investment alternatives and participants exercise control over investments

•Disclose 404(c) status in SPD

•Provide participants with necessary information

➢Even with 404(c) protection, fiduciary is still liable for investment options offered

Best Practices

Select Qualified Default Investment Alternative (QDIA)

•Fiduciary relief if participant does not give investment direction

➢ Automatic enrollment, profit sharing contributions, removal of investment fund

•Life-cycle or target date fund, balanced fund or managed account only

•Provide annual notice of QDIA, allow for transfers out of QDIA at least quarterly

•Fiduciary still responsible for selection and monitoring of QDIA

•Target date funds - explain glide path and "to" or "through" retirement age concept

➢ TDF family of funds or custom TDF?

Best Practices

Create Written Investment Policy Statement (IPS)

•Describe parties involved in plan investments and their duties

•Establish criteria to select and monitor investment options

➢ Quantitative and qualitative standards

•Include road map of actions to take if IPS standards not met

•Follow your IPS and update as necessary

•Review the IPS annually

Best Practices

Periodic Audits and Reviews

•Conduct a fiduciary risk assessment/fiduciary audit

•Implement internal controls to ensure plan compliance Examples:

➢Compare salary deferral elections with actual amounts deducted from paychecks

➢Monitor loan payments

➢Monitor timely deposit of participant contributions

➢Ensure participants over age 70 ½ receive RMDs

➢Verify marital status before making distributions

Best Practices

Prevention

- Subscribe to IRS newsletter (so you know what the regulators are saying)
- Frequent audit issues include
  - ➢ Administration not consistent with plan's definition of compensation
  - ➢ Errors in applying eligibility and participation rules
  - ➢ Late transfer of deferrals
- Review information on DOL's Employee Benefit Security Administration website

Best Practices

Monitoring Service Providers

•Is service provider doing what it promised to do?

•Are you taking advantage of all services being paid for?

•Are fees still reasonable for services provided?

•What services and prices are available in the market?

•When did you last check?

Best Practices - Fees

- Service provider contracts must be for reasonable compensation
  - ➢ Includes investment, record keeping, audit, legal, trust, etc.
  - ➢ Violation is prohibited transaction
- Review fees and fee disclosures to determine if compensation is reasonable in relationship to services performed
- Obtain benchmarking data
- What if you determine compensation is not reasonable?

➢ Renegotiate compensation arrangement

➢ Engage new service provider

Best Practices - Fees

How Does Your Plan Assess Fees to Participants?

•DOL FAB-2003-3

- ➢ Fiduciaries <u>must choose</u> method of allocating plan expenses
- ➢ Must weigh competing classes of participants
  - ➢ Can favor one class if rational reason
- ➢ Pro rata method reasonable in most cases but per capita permissible for fixed expenses
- ➢ Expenses may be charged to individuals (e.g., withdrawal, loan, QDRO fees, etc.)

Best Practices - Fees

Benchmark Recordkeeper and Investment Fund Fees

•What amount is <u>needed</u> by recordkeeper to pay for administration?

•What fees does recordkeeper receive from investments?

- ➢ Record keeping sevices unrelated to Plan investment performance

•If revenue sharing fees do not cover recordkeeping costs, who pays the difference?

•If revenue sharing fees exceed recordkeeping costs, are fees excessive?

- ➢ Is a lower/cheaper share class available?

Best Practices - Fees

- Is it appropriate to use revenue sharing to pay recordkeeping fees?
- If recordkeeping fees are assessed on a per participant basis, should they be charged on a per-capita or a pro-rata basis?
- Should the plan implement an "ERISA account"?
- Should plan adopt "fee equalization" or "fee leveling" policies?

Best Practices - Fees

Allegations in Excessive Fee Litigation

- Failed to monitor investment fees charged by mutual funds
- Failed to leverage plan asset size to lower fees
- Failed to seek lower cost share classes
  - No obligation to choose cheapest possible investment option but must investigate options and document selection.
- Higher mutual fund fees used to offset non-plan related company costs (other plans, payroll)
- Failed to comply with IPS

Fixing Problems

DOL - Voluntary Fiduciary Correction Program

- Fix prohibited transactions such as:
  - Late transfer of participant deferrals and loan payments
  - Expenses improperly paid by plan
  - Improper sale of real property by company to plan

DOL - Delinquent Filer Program

- Minimize penalties due for late filing of Form 5500

Fixing Problems

IRS Employee Plans Compliance Resolution System

•Self correction of operational error allowed in certain circumstances

- If plan sponsor has "established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance"

•Correction with IRS approval of all other errors including

- Failure to timely amend plan for law changes
- Retroactive plan amendments to reflect plan operations
- Must pay compliance fee based on number of plan participants

Surviving a DOL Audit

- Take proactive steps to ensure plan is compliant
- Try to avoid audit triggers
- Participant complaints
- Mistakes on Form 5500
- Using an audit firm that only dabbles in auditing retirement plans

Surviving a DOL Audit

- Notice of audit/list of items to be provided
- Provide by deadline; ask for more time if needed
- Cooperate with DOL agent but do not volunteer any additional information
- Be upfront with any issues

Surviving a DOL Audit

- Use time between DOL notice and on-site visit to address any issues
- Advise ERISA counsel/auditor/service providers if necessary
- Fix any items identified by DOL agent; involve counsel to negotiate if appropriate

Questions

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