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## *Managing Fiduciary Risk Under ERISA:*

### *A Primer for Employers, HR Directors, and Plan Administrators*

# Presenters



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# The ERISA Standard

- ▶ “[T]he standard of care owed by ERISA fiduciaries . . . has been described as ‘the highest known to law.’”

*Herman v. NationsBank Trust Co.*, 126 F.3d 1354 (11<sup>th</sup> Cir. 1997)

# Agenda

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- ▶ Overview of Fiduciary Rules
  - Who is a Fiduciary
  - Fiduciary Duties
  - Prohibited Transactions
- ▶ Strategies for Managing Fiduciary Risk
- ▶ Examples

# In Context . . . 401(k) Plan

- ▶ Selection of Investment Consultant
  - ABC Company sponsors the ABC Company 401(k) Plan, a defined contribution arrangement
  - The Plan authorizes the Administrative Committee to be the “named fiduciary” and Plan administrator under ERISA
  - The Committee is appointed by the Company’s CEO; members of the Company’s HR department assist the Committee with day-to-day Plan administration
  - The Committee has decided to appoint an investment consultant to create and manage model portfolios in which participants may invest
  - What fiduciary issues are implicated by this action?

# In Context . . . Insured Health Plan

## ▶ Denied Claim for Benefits

- Acme Consolidated sponsors a fully-insured health plan
- The plan provides health benefits through an insurance policy issued by Global Insurance Company
- Global decides claims and appeals
- John Doe, an Acme employee, complains to Acme's HR Director that Global denied his claim for chiropractic benefits
- Acme's HR Director calls her contact at Global and directs Global to pay the claim
- Who are the fiduciaries in this scenario?

# ERISA's Fiduciary Duties

- ▶ Who are fiduciaries under ERISA? A person is a fiduciary to the extent he or she:
  - Exercises any **discretionary authority or control** concerning the **management** of a plan
  - Exercises **any** authority or control over the management or disposition of a plan's assets
  - Renders **investment advice** for a fee or other compensation, directly or indirectly, with respect to any monies or property of a plan
  - Has any **discretionary responsibility** in the **administration** of the plan
  - Is a “**named fiduciary**” under the plan

# Examples of Fiduciaries

- ▶ Boards of Trustees
- ▶ Administrative Committees
- ▶ Plan Administrators
- ▶ Plan Trustees (*e.g.*, bank trustees, custodians)
- ▶ Investment Managers/Consultants
- ▶ Named Fiduciaries

# Other Common Fiduciaries

- ▶ Fully-Insured Health Plan
  - Employer (as plan administrator)
  - Insurer (as claims payor)
- ▶ Self-Funded Health Plan
  - Third-Party Administrator (depending on role)
  - Employer (as plan administrator)
  - Administrative/Claims Committee
  - Investment Consultant
  - Trustee/Custodian
- ▶ 401(k) Plan
  - Administrative Committee
  - Investment Committee
  - Investment Consultant
  - Trustee/Custodian
  - Employer (as plan administrator)

# Ministerial Function Exception



“Ministerial functions” include:

- ▶ Applying eligibility rules
- ▶ Calculating service and compensation credits
- ▶ Preparing employee educational material
- ▶ Maintaining service and employment records
- ▶ Preparing reports required by the government

# Ministerial Functions (cont'd)

- ▶ Calculating benefits
- ▶ Orienting and educating new participants
- ▶ Collecting and applying contributions
- ▶ Preparing participant benefit reports
- ▶ Processing claims
- ▶ Making recommendations to decision makers

# In Context . . . 401(k) Plan

## Retention of Investment Consultant

- ▶ Selection is a fiduciary act
  - Discretionary decision
  - Implicates management of plan assets
  
- ▶ Fiduciaries “on the hook” include:
  - Committee members making the decision
  - The appointed investment consultant
  - HR staff? Do we make staff fiduciaries by giving them signature authority?

# In Context . . . Insured Health Plan

## Denied Claim for Benefits

- ▶ Claim denial by Global (insurer) is a fiduciary act
  - Discretionary decision
  - Insurers typically are the only claims fiduciary
- ▶ Does HR Director's involvement create fiduciary status?
  - It depends: does Global pay the claim as a result?
  - Her involvement creates appearance of discretionary authority, and potential fiduciary status

# Fiduciary Duties

- ▶ Fiduciaries must discharge their duties solely in the interests of participants and beneficiaries, and ...

# Fiduciary Duties

- ▶ ***Exclusive Benefit Rule*** ... for the exclusive purpose of:
  - Providing benefits, or
  - Defraying reasonable expenses of plan administration

# Fiduciary Duties

- ▶ ***Prudent Expert Rule*** ... fiduciaries must discharge their duties:
  - With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent 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

# Fiduciary Duties

- ▶ ***Diversification of Assets ...***  
fiduciaries must discharge their duties:
  - By diversifying the investments of the plan so as to minimize the risk of large losses

# Fiduciary Duties

- ▶ ***Comply with Plan Documents ...***  
fiduciaries must discharge their duties:
  - In accordance with the documents and instruments governing the plan

# Fiduciary Duties

- ▶ ***Duty to Inform*** ... fiduciaries have an obligation to:
  - Provide required information about plan
  - Distribute accurate and complete information
  - Disclose *potential* plan changes when under “serious consideration”

# Fiduciary Duties

- ▶ A change is under “serious consideration” when:
  - There is a specific proposal
  - Being discussed for purposes of implementation
  - By senior management with the authority to implement the change

# In Context . . . 401(k) Plan

## Retention of Investment Consultant

- ▶ Exclusive benefit issues
  - Consider consultant's qualifications, rather than outside relationships
- ▶ Prudence issues implicated by selection
  - Prudent expert standard – Committee must become educated
  - RFP process
  - Check references, investigate background
  - Negotiate acceptable contract
  - Careful documentation of process

# In Context . . . Insured Health Plan

## Denied Claim for Benefits

- ▶ Plan document rule
  - Are the chiropractic services actually covered services under the plan's terms?
- ▶ Duty to inform
  - Did the plan and SPD accurately describe the covered and excluded services?
  - Did the HR Director tell Mr. Doe the chiropractic services would be covered, when in fact they were not?

# Fiduciary Liability

## ▶ Personal liability

- Liable for restitution, disgorgement, and other equitable relief
- Liable “to the extent” person is a fiduciary

## ▶ Co-fiduciary liability

- Knowingly participate in breach
- Enable others to breach
- Fail to remedy known breach

# In Context . . . 401(k) Plan

## Retention of Investment Consultant

- ▶ Selection is effort to delegate fiduciary responsibility for plan investments
- ▶ Investment consultant assumes liability for making individual investment decisions

# Prohibited Transactions

- ▶ ERISA Section 406(a)
  - A fiduciary may not engage in any transaction with respect to the plan if he or she knows or should know that such transaction constitutes a direct or indirect:
    - Sale or exchange, or leasing, of any property between the plan and a party in interest
    - Lending of money or extension of credit between the plan and a party in interest

# Prohibited Transactions (cont'd)

- ▶ ERISA Section 406(a), continued . . .
  - Furnishing of goods, services, or facilities between a plan and a party in interest
  - Transfer to, or use by or for the benefit of a party in interest, of any plan assets
  - Acquisition, on behalf of the plan, of any employer security or employer real property in violation of ERISA § 407(a)

# Prohibited Transactions (cont'd)

- ▶ ERISA Section 406(b)
  - A fiduciary with respect to a plan shall not:
    - Deal with the assets of the plan in his own interest or for his own account
    - Act in any transaction involving the plan on behalf of a party whose interests are adverse to those of the plan or its participants
    - Receive any consideration for his or her own personal account from any party dealing with the plan in connection with a transaction involving plan assets

# Prohibited Transactions (cont'd)

- ▶ Parties in interest include:
  - Any fiduciary, counsel, or employee of the plan
  - A person providing services to the plan
  - An employer, any of whose employees are covered by the plan
  - An employee organization (*i.e.*, union), any of whose members are covered by the plan

# Prohibited Transactions (cont'd)

- ▶ Parties in interest . . .
  - An owner of 50% or more of an employer or employee organization described above
  - Certain family members of any individual described above
  - An employee, officer, director (or person with similar powers), or a 10% or more shareholder, of entities described above

# Prohibited Transactions (cont'd)

- ▶ Exemptions from prohibited transaction rules
  - Administrative exemptions
  - Statutory exemptions
    - *e.g.*, reasonable arrangements with parties in interest for office space or services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid

# In Context . . . 401(k) Plan

## Retention of Investment Consultant

- ▶ Section 406(a) issues:
  - Transferring plan assets to party in interest (consultant is a fiduciary and service provider)
  - Exemption if compensation is reasonable
- ▶ Section 406(b) issues:
  - Does appointing fiduciary have a pre-existing relationship with investment consultant?
  - Any indication of self-dealing?

# Prohibited Transaction Penalties

- ▶ “First tier” excise tax equal to 15% of amount involved for the taxable period
  - Assessed against any disqualified person who participates in the transaction
- ▶ “Second tier” excise tax equal to 100% of amount involved if the transaction is not corrected
- ▶ ERISA 502(l) penalty

# Managing Fiduciary Risk



- ▶ Pay Attention to Plan Governance
- ▶ Review Fiduciary Liability Insurance
- ▶ Monitor Plan Fees
- ▶ Delegate Fiduciary Functions

# Plan Governance

- ▶ Periodic fiduciary education/updates
- ▶ Make sure fiduciaries understand the “hat” they wear, and when
- ▶ Hold regular meetings
  - At least twice per year
  - Circulate a written agenda in advance
  - Review investment funds and plan operation
  - Prepare detailed meeting minutes
- ▶ Understand the employer’s role

# Review Fiduciary Liability Insurance

- ▶ Are all “fiduciaries” covered?
- ▶ When was the list of insureds last updated?
- ▶ Carefully review exclusions
- ▶ Negotiate for better terms
- ▶ Report potential claims immediately

# Monitor Plan Fees

- ▶ Recent litigation challenges “excessive” 401(k) fees
  - Allegedly undisclosed to participants
  - Hard dollar payments and “revenue sharing” challenged
  - Plaintiffs allege that fiduciaries did not pay attention
- ▶ Review plan’s fee structure

# Delegating Fiduciary Duties

- ▶ **Our Example . . .** appointment of investment advisor
  - Selection is effort to delegate fiduciary responsibility for plan investments
  - Investment advisor assumes (or shares) liability for making individual investment decisions
- ▶ **How are functions delegated?**
  - Fiduciary duties may be allocated among named fiduciaries, but . . .
  - Plan must expressly authorize delegation
  - Named fiduciaries may also delegate non-trustee fiduciary duties to others

# Delegating Fiduciary Duties (cont'd)

- ▶ Effect of delegation
  - Named fiduciary's liability is limited upon proper delegation
  - The delegation itself is a fiduciary act
  - Delegating fiduciary must monitor the party to whom duties are delegated
  
- ▶ Delegating 401(k) investment responsibilities
  - Co-fiduciary relationship, or
  - "Investment manager" under ERISA § 3(38)

# More Examples

## ▶ Fiduciary Status

- The Company's CEO has the authority to appoint members of a 401(k) plan's administrative committee. Is he or she an ERISA fiduciary?
- Yes, **to the extent** the CEO exercises that authority. The CEO is **not** a fiduciary with respect to actions subsequently taken by the committee, except:
  - Ongoing duty to monitor
  - Co-fiduciary liability

# More Examples

## ▶ **Co-Fiduciary Liability**

- The trustees of a self-funded health plan appoint a TPA. They consider only one candidate and do not investigate its references.
- The TPA is given check writing authority on the plan's account.
- The TPA then engages in a prohibited transaction by using plan assets to pay its own creditors.
- Are the trustees liable?

# More Examples

- ▶ **Co-Fiduciary Liability** (cont'd)
  - Perhaps, as co-fiduciaries of the TPA.
    - “Enabling” prong
      - Appointing an unqualified TPA
      - Failing to monitor the TPA
    - “Failure to remedy” prong
      - If trustees become aware of the prohibited transaction, but do nothing to remedy it

# More Examples

## ► Dual Roles

- Individuals **can** wear two “hats”; fiduciary and settlor
- The line is not always clear; individuals may have responsibilities on both fronts
- Wearing their **settlor** hat, individuals may:
  - Adopt or terminate a plan
  - Amend the plan
  - Set or change employee contribution levels
- The **fiduciary** hat is required when:
  - Administering the plan (communications, plan interpretations, claims and appeals)
  - Managing plan assets (reviewing investment performance, selecting investment managers, choosing investment funds)

# More Examples

## ► Health Plan Fiduciary Issues

- The trustees of a self-funded health plan decide how and where to invest the plan's assets
  - Fiduciary act
- The trustees amend the plan to increase deductibles from \$250 to \$500
  - Typically not a fiduciary act (settlor function)
- HR staff advises an employee about coverage of a service under an insured dental plan
  - Ordinarily, the insurer decides claims and interprets its policy, and thus is the fiduciary
  - HR staff **may** inadvertently become a fiduciary by offering a policy interpretation

# The Bottom Line



- ▶ Be aware of your role(s)
- ▶ Educate yourself
- ▶ Ask questions

# Prudent, Not Perfect

## ▶ The key is a prudent process

“[ERISA’s] test of prudence ... is one of conduct, and not a test of the result of performance of the investment. The focus of the inquiry is how the fiduciary acted in his selection of the investment, and not whether his investments succeeded or failed.”

*Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983)