

SEBC

Southern Employee Benefits Conference

Formal Title: Retirement Plan Fiduciary Concerns
Affecting 401(k) Plans

Our Title: Soda Pop, Potato Chips and Cow Pies



James B. Taylor
Regions Bank

Bert M. Carmody, CPA
Millennium Investment and
Retirement Advisors, LCC

Retirement Plan Fiduciary Concerns

- ❓ *What is the legal landscape for participant directed investments?*
- ❓ *Who in your company is a fiduciary and what are their obligations?*
- ❓ *Are your plan fiduciaries in compliance?*
- ❓ *How does an employer monitor fiduciary compliance?*

Presented by:

James B. Taylor

ERISA Advisory Manager & Vice President,
Regions Institutional Trust

Overview of Fiduciary Concepts & the New Focus on These Issues

And

Bert M. Carmody CPA, CIMC, AIF, CGMA

Principal, MillenniumM Investment and Retirement Advisors, LLC

The Cows Have Left the Barn, One Practitioner's View of Relevant ERISA Litigation

FIDUCIARY = What Does It Mean?

Fiduciary

can be a broad and confusing term, like
Soda or Chips = many different 'flavors'



FIDUCIARY = What Does it Mean and How Did I get Here?

- >ERISA: The Employee Retirement Income Security Act, enacted in 1974, governs the administration of retirement and benefit plans
- >ERISA requires every plan to have at least One Named Fiduciary in the written plan document. Usually Plan Administrator and Trustee are named in plan document
- >Along with the status of fiduciary arises duties and responsibilities, which may lead to liability > personal liability of a fiduciary may occur with some breaches or losses
 - >Fiduciary Liability insurance may be purchased to cover certain fiduciary acts + ERISA bonding requirements cover certain individuals that handle plan assets
- >404(c) = can be complicated and protection may be limited

Exclusive Benefit Rule = Fiduciary Roadmap

- ***Exclusive Benefit Rule***
- **= Fiduciary must discharge duties with respect to the Plan for the Exclusive Benefit of the Participants and their Beneficiaries**
- Common Sense... avoid Conflicts of Interest ... avoid Self Dealing...

Fiduciaries to a Retirement Plan = Who Are They?

- >Plan Administrator is the person named in the plan document, or if no person is named then plan sponsor is the plan administrator. **ERISA Section 3(16)**
- > Plan Fiduciary is a person that: (1) has discretionary authority or control with respect to management of the plan or disposition of plan assets; (2) renders investment advice for a fee; or (3) has discretionary authority or responsibility for the administration for the plan. **ERISA Section 3(21)** (4) takes on fiduciary responsibility by their actions whether or not they know and acknowledge that capacity
- >Investment Advisor = an individual is a fiduciary if he or she agrees in writing to be an investment advisor to the plan and to make specific recommendations that rise to the level of investment advice.
- > Investment Manger = an individual is a fiduciary if he or she agrees in writing to be an investment manager for the plan, having the power to manage, acquire or dispose of any assets of the plan. This individual is either: 1) a registered investment advisor under the 1940 Act; 2) is not registered under the Act but is registered with the state; or 3) is a bank or an insurance company. **ERISA Section 3(38)**
- >**Trustee** is a fiduciary capacity

Your Retirement Plan = How Does This Affect Me?

- **FOCUS** > Who are Plan Fiduciaries in your plan with respect to the selection, monitoring and replacement of investments in the plan?
- **Plan Administrator** = oversees administration of your company's retirement plan
= **Responsible for Administering the plan**
- > must select and monitor/evaluate the following (not an exclusive list):
 - 1. Plan Trustee
 - 2. Service Providers to the Plan
 - 3. Fees for services provided to the plan > reasonable fees > 408(b)(2) disclosures
 - 4. **Investments offered under the Plan** > Plan Administrator's responsibility if not delegated to a 3rd party
 - 5. Decide whether or not to delegate some responsibilities to 3rd parties
 - 6. Hiring of **Consultants, Investment Advisors and/or Investment Managers**
- > Plan Administrator must replace and/or make changes as necessary to meet Exclusive Benefit Rule = Ongoing and Continuous Responsibility/Duty

Investment Fiduciary Considerations = Participant Directed 401(k) Plan

INVESTMENT FIDUCIARY CONSIDERATIONS

1. Prudent Selection of investment list from which participants may direct the investment of their account
 - >broad range of investments that support diversification
 - >not overly broad as could cause confusion
 - = Balanced Approach

2. Fund Expense and Fees = cost of investments = expense ratio
 - >lower cost share classes and passive investments are best practice but not required...cheaper not always better but almost always
 - >some retail share classes may be prudent under certain facts
 - > small size plan with fund level minimums that do not permit institutional share classes
 - >ERISA recapture bucket available where participants bear plan administrative expenses and fund revenue reduces those expenses

How to Address Investment Fiduciary Issues in a 401(k) Plan

- DO IT YOURSELF >>> Plan Administrator is the plan's investment fiduciary
- HIRE AN INVESTMENT ADVISOR>>> fiduciary providing investment advice
- HIRE AN INVESTMENT MANAGER>>>fiduciary with sole investment discretion
- >The Plan Administrator may have the expertise to properly select, monitor and replace the investments in the line up = caution = perceived risk may become a real liability if not done correctly
- >Design a process and document that process > whether you do it yourself or hire a 3rd party

How to address investment fiduciary issues in a 401(k) Plan

- >Hire Investment Advisor = **no discretion but still a fiduciary** under ERISA = makes specific recommendations (that rise to the level of investment advice) with respect to the selection, monitoring and replacement of funds in the plan line up = **Plan Administrator still makes the final decision** = Plan Administrator responsible for prudent selection of Investment Advisor and ongoing monitoring of service + ensure fees for such service are reasonable (where they are charged to the plan)
- >Hire Investment Manager = **sole discretion** to select, monitor and replace the investments in plan line up = fiduciary to the plan = Plan Administrator responsible for prudent selection of Investment Manager and ongoing monitoring of service + ensure fees for such service are reasonable (where charged to the plan)

Plan Administrator = Get What You Pay For!

PLAN ADMINISTRATOR > ensure you have a **clear understanding** of what type of services a 3rd party is providing to the plan

> what services and specific fiduciary capacity is the 3rd party assuming

> what are the fees

> this information may be found in the **408(b)(2)** disclosure provided to you by each covered service provider > contract language should support/affirm the services & fiduciary capacity > 404(a)(5) participant disclosures

> All 3rd parties must specifically acknowledge, in writing, the fiduciary capacity (if any) they are assuming with respect to the plan.

>> Transparency with respect to fees is best practice and in many cases required = plan administrator should clearly understand what they pay, how fees are paid and what the plan is receiving for such fees

>>> Plan Administrator should be wary when a 3rd party is not clear with respect to the services they provide, the fiduciary capacity they assume and the fees they charge

Where To Go From Here?

PLAN ADMINISTRATOR

- >Can Assign Duties to 3rd Parties
 - >**BUT** Never Completely Eliminates Your Responsibility to the Plan
- >volatile market > aggressive legal climate > heightened scrutiny by regulators and others
- Yale Letters >Professor reviewed data > mailed letters outlining potential fiduciary breaches to Plan Sponsors
- PLAN ADMINISTRATOR> know your responsibilities or hire someone that can help you understand your responsibilities and how to address them
- PERIODIC REVIEW OF AGREEMENTS & FEES = 408(b)(2)>404(a)(5)
- MONITOR PERFORMANCE OF 3rd PARTIES & ADJUST AS NECESSARY>
- PRUDENTLY DELIBERATE AND DOCUMENT PLAN ADMINISTRATION>

CONTACT INFORMATION JAMES B. TAYLOR

- James Taylor
- ERISA Advisory Manager & Vice President
- Regions Institutional Trust
- james.b.taylor@regions.com
- 251-694-1405



The Cows Have Left the Barn

or...One Practitioner's View of Relevant
ERISA Litigation

Presented to
Southern Employee Benefits Conference

Bert M. Carmody
CPA, CIMC, AIF, CGMA

The Barnyard



- Named/de facto fiduciaries are prime targets
- “New” regulations – disclosure and process
- Higher IRS and DOL visibility **1-800-4-USA-DOL**
- “New” and *uncomfortable* lessons from litigation
- Increasing sophistication of plaintiffs’ bar
- Recession, market volatility and benefit cutbacks = noisy and unhappy campers

Litigation Focus



- Litigation centered around
 - Who the fiduciaries are
 - The assertion that fiduciary duties were breached
 - The prudent selection of investments
 - Balance between prudence, eligibility and fees
 - That fees are too high
 - That fees and compensation to providers not disclosed sufficiently

Litigation Process



- ERISA plans in federal court
 - Some governmental plans in state court
- DOL very active in litigation
- Damages – make whole – no punitive damages - “equitable relief”
- Some opinions are broad...others very narrow – read carefully

Litigation Process



- Settlements
 - Not law but...
 - Not an admission of liability or “guilt” but...
 - Settle for a dollar amount and remedial actions proscribed
- ***Learn*** lessons from settlements

Fiduciary Duties Litigation



- At issue: Acting in the best interests of the Participants?
- At issue: Who are the fiduciaries?
- You?
 - *LaRue v. DeWolff*
 - Participant's transfer instructions not executed timely
 - Plan Sponsor liable for difference
 - Be aware of duties/liability if you have discretionary control of a participant's account
 - *CIGNA Corp. V. Amara* – SPDs must be correct
- Your service provider(s)?
 - *Ellis v. Rycenga Homes* – Broker gave investment advice and...acted as and was a fiduciary

Fiduciary Duties Litigation



- *Pfeil v State Street Bank*
 - ERISA 404 (c) protection does not extend to the overall fiduciary duty of selection and monitoring of investments
 - Having a poor investment in an otherwise good line-up is akin to “one bad apple” spoiling the whole bunch
 - Participant are not the fiduciaries when they put their contributions/balances into poor performing funds - goes beyond §404(c) protection.
 - The duty of a fiduciary to monitor *all* investments reaffirmed

Tussey v. ABB



- Fee and Fiduciary Duties case
 - Company did not follow IPS – rebates and rebate monitoring required but not performed
 - Added a more expensive fund replacing significantly less expensive fund
 - Company had minimal oversight over payments, costs and fees to service provider
 - Did not listen to outside consultants' advice
 - RK performed other services at below market rates – Excess fees charged to the Plan - subsidized outside services

Tussey v. ABB



- *More....*
 - Meaningful fund fee benchmarking not performed
 - Company did not track float income
 - Provider (a fiduciary) breached its duties in not distributing float income
 - When distributed – to the wrong places
 - Fiduciaries held liable for \$36 mm...could have been a lot more
- Note case is being appealed – 8th circuit

DOL Actions



- Both Civil and Criminal cases
- Based Around
 - “Failing to operate the plan prudently and for the exclusive benefit of participants;
 - Using plan assets to benefit certain related parties to the plan, including plan administrator, plan sponsor, and parties related to these individuals;
 - Failing to properly value plan assets at current fair market value, or to hold plan assets in trust;
 - Failing to follow terms of the plan (unless inconsistent with ERISA);
 - Failing to properly select and monitor service providers;”

Fee Litigation



- At issue: Are fees excessive?
 - Retail v institutional shares
- At issue: Does you know the difference?
- *Hecker v. Deere, Loomis v. Exelon, Renfro* and other related cases
 - Retail shares OK if large range of investments offered and sufficient number are passive/index/low cost.
 - Funds in Hecker (>60), Loomis (>30), Unisys (>70)
 - Cheap is not necessarily best
 - Show a consistent process for selection/monitoring

Tibble v. Edison



- Fee Case:
 - Six retail funds were in plan with nearly identical funds in cheaper share classes available
 - Three remained in statute of limitations:
 - Plan was eligible for cheaper share classes but actions to request a lower share class did not occur
 - Retail shares (fees) were not appropriate here (\$2.1 bb Plan)

Tibble v. Edison



- Lessons Learned:
 - Document fully decisions made to select investment options
 - Fund with higher fees attractive?
 - Document decision
 - Benchmark/survey for reasonableness
 - Look at nearly identical funds in cheaper share classes available
 - Changes in fund ownership, name or ownership should trigger a new diligence review
 - Fiduciaries have the duty to ***Ask for the better deal***
 - 9th Circuit reaffirmed Tibble

Fee Litigation



- Settlement: *Braden v. Wal-Mart*
 - American Funds Class A shares for this multibillion dollar plan
 - Limited investment selection
 - Settlement amount: \$13.5 mm
 - Provider to provide \$10mm
 - Wal-Mart to provide \$3.5 mm
 - Removed Class A shares and added index funds
 - Comply with fee disclosure regulations

Fee Litigation



- Settlement: *Kanawai V. Bechtel Corp.*

October 14, 2010 --- Engineering giant Bechtel has agreed to an \$18.5 million settlement of an excessive 401(k) fee suit.

Bechtel has agreed for a three-year period to:

not use any of its own affiliates to act as the investment manager for the 401(k) plan,

greatly enhance the disclosures it makes about investment and recordkeeping fees,

not offer any retail mutual fund as investment options, **prohibit all** of the plan's separate account investment managers from investing in retail mutual funds,

not use plan asset-based pricing for recordkeeping service fees,

Conduct **a competitive bidding** process for recordkeeping services when the plan's current contract with J.P. Morgan Retirement Plan Services expires, which is scheduled to occur no later than 2012.

Depending on how long they've been with the company, employees would receive a portion of **settlement proceeds** as a credit in their accounts. Those no longer in the plan would receive checks.

Litigation Case Scorecard



- Many dismissed
- Some settled
- Several decided in favor of defendants
- Two went to trial (*Tussey & Tibble*) decided mostly in favor of plaintiffs

- But.....

Painful, Expensive and in the Ditch



Lots of money...and time spent – *unproductively*

Lots of *pouring* over records for discovery

Lots of folks *looking* in your knickers

Lots of *bad* media relations – bad press

Employee relations and retention *issues*

Loss of confidence in existing processes

– *No one* ends up happy



.....In short – a *nightmare!*

Avoiding the Cow Pies



- **Know** who your fiduciaries are:
 - Who are your *Parties-in-interest*?
 - Which service providers are fiduciaries – which are not, acting as....
 - Examine your §408(b)(2) to see if CSPs are serving in a fiduciary capacity (or not)
- **Closely** read your 408(b)(2) notices
 - Also.....read the contracts
 - Plan Sponsors: you are on the hook for analysis and conclusions
 - Necessary services? Reasonable provider pay?
- **Demand** justification for asset based pay
- **Demand** justification for what work gets done by your providers to get the money they are paid

Avoiding the Cow Pies



- **Demand** a rationale why for a large number of investment options (>40, 50, 60)
 - How does your advisor do due diligence on so many?
 - You are actually blessing this number of investments?
 - Why three large cap blends? Getting paid on one more than others?
- **Ask for/Demand** the best deal available
- **Demand** justification of actively managed funds – v. passive/index funds
- **Read/Review** your 5500 Schedule A or C and ask about how/why compensation has increased over the years
- AND.....**document** this stuff!

Contact Information



Bert Carmody, CPA, CIMC, AIF, CGMA

Principal

MillenniumM Investment and Retirement Advisors, LLC

(404) 325-0125

bertc@fix401k.com

Disclaimer and Observations

- A non-attorney's view of ERISA litigation
 - Do not play one on TV, did not stay at a Holiday Inn Express...
 - Observations not necessarily one an attorney would have
 - Certainly not practicing law!
- Litigation and results are not just an attorney issue – affects *all* of us in this space
- We need to know the important cases so we can do the right things