Fiduciary Duties of Retirement Plan Sponsors

Presented by:

Kathy D. Aslinger, Esq.

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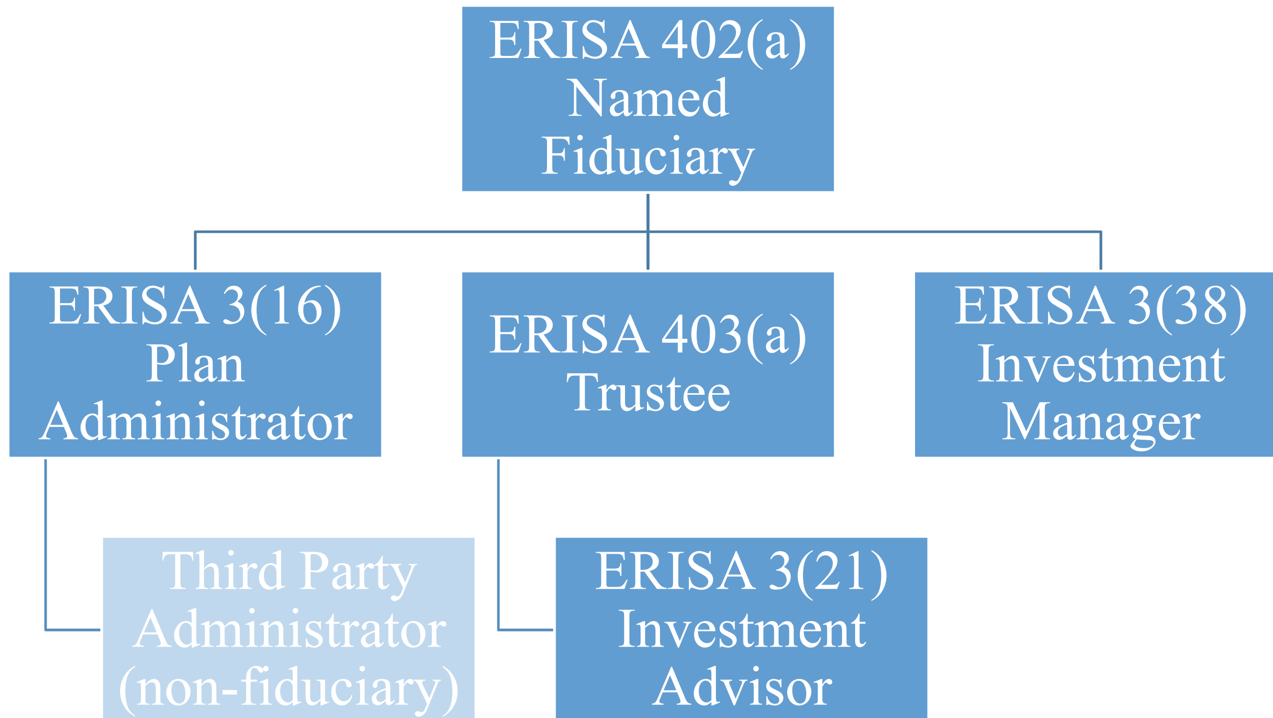
Who is a Fiduciary?

- Generally, a person is a fiduciary with respect to a plan to the extent he or she:
  - exercises any discretionary authority or discretionary control respecting management of the plan or exercises any authority or control respecting management or disposition of plan assets;
  - renders investment advice for a fee or other compensation, direct or indirect, with respect to any assets of the plan, or has any authority or responsibility to render the investment advice; or
  - has any discretionary authority or discretionary responsibility in the administration of the plan. ERISA § 3(21)(A).

Who is a Fiduciary?

- A person may be a fiduciary with or without a "fiduciary" title
- A person whose title requires him/her to perform one of more fiduciary functions is a fiduciary
  - For example, plan administrators or trustees, by the very nature of their positions, have "discretionary authority or discretionary responsibility in the administration" of the plan, and are therefore fiduciaries. DOL Reg. § 2509.75-8, Question D-3.
- On the other hand, a person lacking a "fiduciary" title can still be a fiduciary if he/she performs a fiduciary function
  - For example, courts have found that attorneys, accountants, and even insurance agents were fiduciaries when those persons performed fiduciary functions

ERISA Fiduciary Hierarchy



Delegating Fiduciary Responsibilities

- ERISA requires the plan document to identify a named fiduciary who is ultimately responsible for the plan. The named fiduciary may delegate fiduciary responsibilities to outside experts who are functional fiduciaries based on their actions.

3(21) Investment Advisor	3(38) Investment Manager
• Provides investment advice to trustees and trustees make final decisions • Investment advisor and trustees are jointly liable for investment decisions	• Has discretion over the management of the plan or control of its assets • Investment manager assumes liability for investment decisions under written acknowledgment

- The trustee's role in outsourcing is to prudently select and monitor fiduciary service providers. Outsourcing **does not** release a trustee from all fiduciary responsibilities.

Once a Fiduciary, Always a Fiduciary?

- A person who is a fiduciary for some purposes, may not be a fiduciary for other purposes
- For example, an employer that also acts as a plan administrator is said to wear "two hats," and only when the employer acts in its fiduciary capacity must it comply with its fiduciary duties. *Hunter v. Caliber System, Inc.*, 220 F.3d 702, 718 (6th Cir. 2000).
  - Courts typically distinguish between employer actions that constitute "management" or "administration" of a plan and those that are said to constitute merely a "business decisions" that have an effect on a plan; the former are deemed "fiduciary acts" while the latter are not. *Id.* (citing *Sengpiel v. B.F. Goodrich Co.*, 156 F.3d 660, 666 (6th Cir.1998)).
  - In other words, an employer is usually not acting in a fiduciary capacity when it makes plan design, plan amendment or plan termination decisions. Those are settlor and not fiduciary decisions. *See, e.g., Lockheed Corp. V. Spink*, 517 U.S. 882, 890 (1996).

Carolinas Elec. Workers Ret. Plan v. Zenith Am. Solutions, Inc. and Determining When a Third Party Administrator Acts as a Fiduciary

Carolinas v. Zenith (factual background)

- Zenith American Solutions, Inc. acted as the third-party administrator (TPA) for Carolinas Electrical Workers' Retirement Plan, an employee pension benefit plan
- Zenith recommended that the plan's trustees convert the plan's accounts from cash-based accounting method to accrual-based method
- Zenith mishandled the conversion, allocating more funds (approximately $1.4 million) to participant accounts than the plan had in total assets
- Another accounting firm discovered the errors and informed the plan trustees approximately seven years later

Carolinas v. Zenith (factual background)

- The plan trustees filed suit against Zenith, claiming that Zenith breached its fiduciary duties to the plan when it:
  - (1) convinced the trustees to convert the plan's accounts from the cash-based accounting method to the accrual-based method;
  - (2) mishandled the conversion so that it allocated more funds to participant accounts than the plan had in total assets; and
  - (3) failed to inform the trustees of the error for approximately seven years.
- Zenith moved to dismiss the claim on the grounds that it was not a plan fiduciary

Carolinas v. Zenith (Lower Court)

- The district court granted Zenith's motion to dismiss, finding that Zenith's alleged activities as TPA were ministerial, rather than discretionary, in nature, and thus did not give rise to fiduciary responsibility under ERISA.
  - While Zenith recommended the conversion, the change was only made after the trustees voted in favor of the recommendation; Zenith did not have the discretionary authority to make the change on its own.
  - The rest of Zenith's activities – recalculating the benefits, reconciling accounts, and sending notices to participants – were also ministerial functions.

Carolinas v. Zenith (11th Circuit)

- The 11th Circuit affirmed the lower court's dismissal, after analyzing Zenith's activities under the relevant statute, 29 U.S.C. § 1002(21)(A):
- An entity performs a fiduciary function under ERISA when it:
  - (1) "exercises any discretionary authority or discretionary control respecting management of [an ERISA] plan";
  - (2) "has any discretionary authority or discretionary responsibility in the administration of [the] plan"; or
  - (3) "exercises any authority or control respecting management or disposition of [plan] assets."

Carolinas v. Zenith (11th Circuit)

- 1. Zenith did not exercise any discretionary authority or discretionary control respecting management of the plan.
  - Trustees alleged that Zenith exercised discretionary authority by maintaining plan funds, calculating participant accounts, and determining plan eligibility.
    - Accordingly, when Zenith's miscalculated the amount paid out to participants, the trustees alleged it did so in an exercise of discretionary authority.
  - But while Zenith made the miscalculation, the funds were not under Zenith's authority or control, nor did Zenith itself wrongly pay out the funds.
  - The 11th Circuit said that Zenith's actions reflected a role in accounting for the plan's assets, not exercising authority or control over the assets.

Carolinas v. Zenith (11th Circuit)

- 2. Zenith did not have any discretionary authority or discretionary responsibility in the administration of the plan
  - Trustees alleged that, by failing to inform trustees of the accounting errors, Zenith interfered with the trustees' authority to manage the plan.
  - However, Zenith did not take any discretionary action itself concerning the errors. It merely made a miscalculation.
  - Moreover, once the errors came to light, the trustees made the decisions concerning corrective action, including instructing Zenith to reconcile the accounts. Zenith did not take any discretionary action at this point, it merely followed the trustees' instructions.

Carolinas v. Zenith (11th Circuit)

- 3. Zenith did not exercise any authority or control respecting management or disposition of plan assets.
  - Trustees alleged that Zenith had check-writing authority and thus had actual authority or control over the plan assets.
  - However, Zenith merely billed trustees for time spent correcting mistakes. Zenith also wrote a check on the plan's account made payable to itself, then submitted it to the trustee chairman for his signature.
  - These actions did not demonstrate that Zenith had check-writing authority. Rather, they showed that Zenith was not a signatory on the plan's bank account and could not dispose of plan assets without the trustees' approval.

Carolinas v. Zenith (11th Circuit)

- Because none of Zenith's activities as described gave rise to fiduciary functions under the statute, the 11th Circuit affirmed the district court's decision and dismissed the claims.

What are a Fiduciary's duties?

- ERISA sets forth four general fiduciary duties:
  - 1. Exclusive Benefit Rule – The fiduciary must discharge duties with respect to the Plan for the exclusive benefit of the participants and their beneficiaries. ERISA § 404(a)(1)(A).
  - 2. Prudent Man Rule – A fiduciary must act "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity" would act
    - This is an objective standard based upon how a person with experience and knowledge of a certain area would act in a given situation
    - If a fiduciary lacks the expertise for a certain area then the fiduciary must obtain expert help. § 404(a)(1)(B).

What are a Fiduciary's duties?

- 3. Diversification Rule – A fiduciary must diversify investments in order to minimize risk of loss unless it would be considered prudent to not diversify investments. § 404(a)(1)(C).
- 4. Plan Document Rule – A fiduciary must act in accordance with the Plan documents but only to the extent that the Plan is consistent with ERISA requirements. § 404(a)(1)(D).
  - Thus, a fiduciary must know and act in accordance with the Plan and must have sufficient knowledge of the ERISA requirements

Application to Governmental Plans

- ERISA exempts governmental plans from its fiduciary and prohibited transaction provisions. ERISA § 4(b).

- As a result, state law governs the fiduciary requirements for the operation and investment of plans sponsored by governmental entities

What are a Fiduciary's duties? (Governmental Plans)

- Tennessee has codified the fiduciary duties of a trust fiduciary in its role as an investor under the Uniform Prudent Investor Act, T.C.A. § 35-14-101-114 (the "Act"). Duties under the Act include:
- Prudent Investor Rule – A fiduciary must invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution. T.C.A. § 35-14-103 and 104.
  - This is an objective standard based upon how a person with experience and knowledge would act in a given situation.
- Duty of Loyalty – A fiduciary must invest and manage the trust assets solely in the interest of the beneficiaries. T.C.A. § 35-14-107.
- Duty of Impartiality – A fiduciary must act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries. T.C.A. § 35-14-108.
- Duty to Diversify – In most cases, a fiduciary must diversify the investments of the trust. T.C.A. § 35-14-105.
- Reasonable Expenses – A fiduciary may only incur costs that are appropriate and reasonable. T.C.A. § 35-14-109.

What are a Fiduciary's duties? (Governmental Plans)

- Where the Uniform Prudent Investor Act is inapplicable, governmental plans will be guided by the common law of trusts, as well as other state statutes, plan documents, and, by analogy, ERISA and its interpretive cases. *See, e.g., Sharma v. Washington Metro. Area Transit Auth.*, 58 F. Supp. 3d 59, 63-64 (D.D.C. 2014) (in a case involving a governmental plan, in the absence of statutory and case law, the court applied the common law of trusts)

Tibble v. Edison and the Continuing Duty to Monitor Retirement Plan Investments

NOVEMBER 7, 2017

Tibble v. Edison (factual background)

- Edison International sponsored a 401(k) Plan (the "Plan")
  - Plan had $3.8 billion in assets and approximately 20,000 participants and beneficiaries across the entire Edison International workforce
  - Plan contained employees' elective deferrals and employer matching contributions
- Before 1999, the investment line-up was limited to six investment options
- After 1999, the Plan grew to contain 10 institutional or commingled pools, 40 mutual fund-type investments, and an indirect investment in Edison stock known as a unitized fund
- Investment options selected by Edison International Trust Investment Committee (the "Investment Committee")

Tibble v. Edison (factual background)

- Six of the 40 mutual funds were similar to those offered to the general investing public, so-called retail-class mutual funds, which had higher administrative fees than alternatives available only to institutional investors
  - 3 were added in 1999, and 3 in 2002
- In 2007, several individual participants and beneficiaries of the Plan filed a lawsuit on behalf of the Plan and all similarly situated individuals ("petitioners") against Edison International and others ("respondents")
  - Argued that respondents acted imprudently by offering six higher priced retail-class mutual funds as Plan investments when materially identical lower priced institutional-class mutual funds were available (with lower administrative costs)
  - Specifically, claimed that a large institutional investor with billions of dollars, like the Plan, could obtain materially identical lower priced institutional-class mutual funds that are not available to a retail investor
  - Asked, how could respondents have acted prudently in offering the six higher priced retail-class mutual funds when respondents could have offered them effectively the same six mutual funds at the lower price offered to institutional investors like the Plan?

Tibble v. Edison (Lower Courts)

- As to the 3 funds added to the Plan in 2002, the District Court agreed with the petitioners
  - Reasoned that respondents had "not offered any credible explanation" for offering retail-class, higher priced mutual funds that "cost the Plan participants wholly unnecessary fees," and concluded that, with respect to those mutual funds, respondents had failed to exercise "the care, skill, prudence and diligence under the circumstances" that ERISA demands of fiduciaries
- As to the 3 funds added to the Plan in 1999, however, the District Court held that petitioners' claims were untimely because, unlike the other contested mutual funds, these mutual funds were included in the Plan more than six years before the complaint was filed in 2007. As a result, the 6–year statutory period had run
- The 9th Circuit affirmed the District Court as to the 6 mutual funds. With respect to the 3 mutual funds added in 1999, it held that petitioners' claims were untimely because petitioners had not established a change in circumstances that might trigger an obligation to review and to change investments within the 6–year statutory period

Tibble v. Edison (Supreme Court)

- On May 18, 2015, the Supreme Court issued a (rare) unanimous decision holding that the 9th Circuit erred in finding that the claims regarding the three mutual funds added in 1999 were untimely
- Reasoned that the 9th Circuit failed to recognize that under trust law a fiduciary is required to conduct a regular review of its investment with the nature and timing of the review contingent on the circumstances

Tibble v. Edison (Supreme Court)

- Specifically, the Court's decision was based on ERISA's prudent person rule - that a fiduciary must discharge its responsibility "with the care, skill, prudence, and diligence" that a prudent person "acting in a like capacity and familiar with such matters" would use. ERISA § 404(a)(1).
- The Court acknowledged that "in determining the contours of an ERISA fiduciary's duty, courts often must look to the law of trusts."
- Held that ERISA, like trust law, imposes upon plan fiduciaries a "continuing duty to monitor trust investments and remove imprudent ones," which is distinct from the duty to prudently select the investment options in the first instance
- This involves "systematically consider[ing] all the investments of the trust at regular intervals to ensure that they are appropriate"

Tibble v. Edison (Supreme Court)

- Thus, the Supreme Court held that breach of fiduciary duty to monitor may be timely under ERISA's 6-year period of repose, even though the initial selection of the investment occurred outside of that period – and even though there was no "significant change in circumstances" that would have caused the fiduciary to revisit its initial selection decision

Duty to Monitor for Governmental Plans

- The comments to the Uniform Prudent Investor Act state that the duties set out under the Act apply both to investing and managing trust assets, and clarify that "managing" includes "monitoring," that is, the fiduciary's "continuing responsibility for oversight of the suitability of investments already made"
- In this way, Tennessee's Uniform Prudent Investor Act has already codified a standard very similar to the ERISA standard outlined by the Supreme Court in *Tibble,* which, of course, was based on the Uniform Prudent Investor Act and the common law of trusts
- Thus, while *Tibble* is technically an ERISA case, its holding that plan fiduciaries have a continuing duty to monitor investments applies to governmental plans as well

Duty to Monitor Investments – Open Issues

- Unfortunately, the *Tibble* Court expressed no view as to the scope of the duty to monitor
- The full implications of the Supreme Court's decision and the scope of the duty to monitor remain uncertain. Open issues include:
  - Frequency of Review
  - Scope of Review
  - Depth of Review
  - Special Circumstances

What is a Fiduciary's potential liability?

- A fiduciary who breaches his or fiduciary duties may be personally liable to the Plan and beneficiaries
  - Includes obligation to make the Plan whole by restoring any losses caused by the breach

Statute of Limitations

- ERISA provides a specific Statute of Limitations for breach of fiduciary duty claims. ERISA § 413.
  - Claims must be brought:
    - Three years after actual knowledge of the breach; or
    - Six years after the last act in a breach or, in the case of an omission to act that is a breach, after the last date on which the breach could be cured
- Non-ERISA plans are governed by state Statutes of Limitations

Best Practices for Fiduciary Protection

- Practice No. 1: Hold regular meetings with consultants, providers and other advisors to review information about the operation and investment activities of the plan and to evaluate methods for improvement; keep minutes
- Practice No. 2: Prudently select the investment options (including the default investment option for participant-directed plans):
  - Options should constitute a broad range of investment categories;
  - Options should be suitable and appropriate for the Plan and the participants; and
  - The investment considerations and decisions should be based on generally accepted investment theories and prevailing investment industry practices. Competent advisors may be engaged to assist in understanding and applying these principles
- Practice No. 3: Adopt a written Investment Policy Statement for the Plan, setting out the investment goals, strategies, and appropriate benchmarks. Review it annually, make any necessary changes, and document the process

Best Practices for Fiduciary Protection

- Practice No. 4: Establish a process designed to monitor the performance of the investments in accordance with the criteria and benchmarks set forth in the Investment Policy Statement, and remove or replace investments as appropriate
  - Monitor the performance of the Plan's investments on at least an annual basis; document the process, conclusions, and the basis for these conclusions
  - Monitor fees and expenses, negotiating reductions in costs when assets grow and the market changes
  - Consider a competitive benchmarking process every few years to understand the market for services
  - If mutual funds are used, understand the share classes chosen. Investigate whether cheaper classes are available and/or appropriate, and whether any of the fees can be recaptured for the participants' benefit
  - Document what services the plan is receiving in exchange for the fees that are directly or indirectly paid from Plan assets
- Practice No. 5: Document all activities including the process of selecting and monitoring investments, because regardless of the process used, the fiduciary should be able to demonstrate compliance with the legal standards

Best Practices for Fiduciary Protection

- Practice No. 6: Prudently select independent, competent advisors to assist. Once the advisor is selected, monitor the performance of the advisor, and remove and replace the advisor if it fails to perform adequately or properly
  - Identify all plan fiduciaries, and if necessary, formally delegate authority and discretion
  - Determine the level of fiduciary/investment responsibility you wish to delegate, then use a prudent process to select the provider
  - Read and understand all service contracts before they are signed; ensure they properly reflect the relationship and that the providers assume appropriate levels of responsibility
  - Identify conflicts of interest
- Practice No. 7: For participant-directed plans, comply with the requirements of ERISA § 404(c) to obtain relief from liability for losses that are the direct result of a participant's exercise of control over his or her account

Additional Information on the Firm

Kennerly Montgomery is a general practice law firm that has provided legal advice to clients for almost 100 years. KM attorneys practice in a variety of areas, representing municipal clients, including local governments, agencies and public utilities.

Bill Mason, Kathy Aslinger, and Ashley Trotto practice extensively in employee benefits law, which includes design, documentation, administration, audit, litigation, termination and qualification of employee health and welfare and pension plans for public, tax-exempt and private employers. The Firm sponsors various prototype retirement plans and prepares both interim amendments and discretionary amendments for all plan types as well as counsels with fiduciaries on ERISA and Federal & state law obligations. They represent clients before various agencies regulating employee benefits.

A Little About Your Presenters

Bill Mason received his JD from Harvard Law School in 1974, and has been practicing law for 40 years, most of that time in employee benefits for governments. He worked for the Tennessee Valley Authority from 1974 – 1986, Wagner Myers & Sanger PC, from 1986 – 1988, and William E. Mason PC from 1988 – 2009. Bill joined Kennerly Montgomery in 2009. Mr. Mason serves on the Board of Directors for the Legacy Park Foundation and the Education Subcommittee for the United Way of Greater Knoxville. He is the past Chair of the Hillcrest Healthcare Board of Directors.

As a leader of Kennerly Montgomery's employee benefits practice, Kathy Aslinger focuses on advising fiduciaries for the benefit of participants, assisting both private and governmental clients in the design, implementation and maintenance of their employee benefit plans, including 401(k), pension, cafeteria, and health plans. She commonly assists clients in maneuvering through the complex world of audits, fiduciary liability issues, DOL and IRS compliance, HIPAA, COBRA, ERISA and state law obligations, as well as Affordable Care Act compliance. Kathy has been practicing law for over 15 years and has been with Kennerly Montgomery since January 2010. In addition, Kathy serves on the Board of Directors for Uplands Village, a continuing care retirement community in Pleasant Hill, Tennessee.

Ashley Trotto joined Kennerly Montgomery as a law clerk in 2012 and as an associate attorney in the Firm's employee benefits practice in 2013. Ashley concentrates on the Affordable Care Act and has been a frequent speaker on Affordable Care Act issues. She graduated *cum laude* from the University of Tennessee College of Law in 2013, and she also earned a Bachelor of Science in Psychology, *summa cum laude*, from the University of Tennessee in 2009. She's the energy behind the Firm's on-going kindergarten book project at Christenberry Elementary.

Bill Mason: wemason@kmfpc.com

Kathy D. Aslinger: kaslinger@kmfpc.com

Ashley N. Trotto: atrotto@kmfpc.com

Ben Cunningham: bcunningham@kmfpc.com

KENNERLY, MONTGOMERY & FINLEY, P.C.

550 MAIN STREET, FOURTH FLOOR | KNOXVILLE, TN 37902

P.O. BOX 442 | KNOXVILLE, TN 37901

PH (865) 546-7311 | FX (865) 524-1773 | WWW.KMFPC.COM

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