2017 JOINT SPRING MEETING

GROUP LEGAL SERVICES ASSOCIATION

SOLO, SMALL FIRM, AND GENERAL PRACTICE DIVISION

STANDING COMMITTEE ON GROUP & PREPAID LEGAL SERVICES

MAY 18-20, 2017

SCOTTSDALE, ARIZONA

ERISA UPDATE: PART I

THURSDAY, MAY 18, 2017
10:30 – 11:30

PRESENTER: KATHERINE HESSE

About the Presenter

Katherine A. Hesse is a founding partner of Murphy, Hesse, Toomey & Lehane, LLP, a multi-service law firm with offices in Quincy, Boston, and Springfield, Massachusetts.

Ms. Hesse practices primarily in labor and employment and employee benefits law. She serves as counsel to business, government, and not-for-profit entities including hospitals, colleges and single and multi-employer private and public retirement and welfare plans. She counsels clients on a daily basis on employment and benefits issues and has litigated numerous employment and benefits cases before the state and federal trial and appellate courts, administrative agencies and arbitrators. Ms. Hesse is also an active practitioner in a variety of forms of alternative dispute resolution including mediation, conciliation, fact finding and several forms of arbitration.

Ms. Hesse sits on the Board of the International Foundation of Employee Benefit Plans, chairs its Government Liaison Committee, and formerly chaired its Attorneys Committee. She also served as president of the International Society of

Certified Employee Benefit Specialists. She sits on the editorial board of Benefits Quarterly, the Pension Editorial Advisory Board for Wolters Kluwer (which houses brands such as Aspen Publishing and CCH), and formerly wrote the legal column for Aspen Publishers, Inc. Managing Employee Health Benefits. Ms. Hesse speaks frequently on employment and benefits issues.

A graduate of Smith College and Boston University School of Law, Ms. Hesse is admitted to the federal and state trial and appellate bars in Massachusetts and the District of Columbia and the Supreme Court of the United States. Ms. Hesse has received a number of awards for her professional service and for her charitable commitments including the 1997 recipient of the prestigious Cushing-Gavin Award for excellence in providing legal counsel.

ABA GLSA/GP Solo Joint 2017 Spring Meeting

Fiduciary Responsibility Refresher

Part 1

Presented by

Katherine A. Hesse

Murphy, Hesse, Toomey & Lehane, LLP

May 18, 2017

Fairmont Scottsdale Princess, Scottsdale

Purpose of Today's Session

- To give you some basic tools to allow you to be prudent fiduciaries of your pension and health funds.
- To ensure you understand the legal framework within which you operate. See how key cases illustrate this.
- To refresh your knowledge of best practices for trustees and administrators in providing benefits to covered employees.
- To leave you with a checklist of key take-aways.

Overview

- Part 1 - Maintaining Tax-exempt Status
- Part 2 - Key Documents Every Trust Should Have
- Part 3 - What It Means to Be a Fiduciary
  - The New DOL Fiduciary Rules
- Part 4 - Selecting and Monitoring Providers
- Part 5 - Guiding Principles
  - Spotlight: Communications and Disclosure
- Part 6 - Key Takeaways
- Parts 5 and 6 will be discussed in the second half of this presentation.

Part 1. Tax-Advantaged Status

- We will be focusing mostly on the "fiduciary" standards the DOL enforces and Key takeaways (Parts 3 and 4).
- However, first, it is important to remember that all plans, even governmental plans, are also subject to certain IRS rules.

Plan Qualification

- The requirements for tax-advantaged status vary according to the type of plan.
- Some of these requirements include:
  - Written document
  - Exclusive benefit rule
  - Minimum vesting and participation requirements
  - Non-assignment or alienation
  - Communication of plan
  - Nondiscrimination requirements

Taking Care of Your Trust

- Trustees should establish practices and procedures to ensure the plan is operated in accordance with the plan document so participants and beneficiaries receive their proper benefits.
  – As you will see, this is also a fiduciary requirement.
- Be aware that the law and regulations in this area frequently changes, especially post-ACA or MPRA.

Plan Amendments

- The terms of the plan may be amended.
- Be very wary of eliminating or cutting back benefits retroactively.
- Even where not required by law, best practice is to provide sufficient advance notice of the change under the circumstances.

Part 2. Key Plan Documents

- Trust Document
- Plan
- IRS letter
- Collective bargaining agreement(s)
- Annual Audited Financial Statements
- Policies of Insurance

Part 2. Key Plan Documents (cont'd)

- Summary plan description/certificates of insurance/wrap around document
- Policies and Procedures
- Minutes of meetings
- Written contracts with all vendors

- Tip: Make sure to keep copies in the fund office of all of these documents. Some of them will need to be kept at other locations as well.

Key Plan Documents – The Trust

- What are some key provisions it should cover?
  - Sets forth the plan sponsors
  - States the purpose of the trust
  - Defines terms
  - Provides for the composition of the Board of Trustees and how Trustees are appointed and removed
  - Sets forth the duties and powers of the Trustees (general, investment, collection, audit, hiring staff, leasing space, etc.)
  - Determines how and when meetings can be called and the voting process
  - Provides the Trustees with discretion to interpret the plan and resolve ambiguities
  - Governs how the Trustees will vote , including a provision for arbitration
  - Determines how amendments to the Trust may be made and how the Trust may be terminated.

Other Key Plan Documents

- The Plan
  - Provides what the plan of benefits is
  - Sets forth eligibility rules, waiting periods, etc.
  - Provides procedure for participants to apply for benefits
  - Sets out appeal process for those denied benefits
- IRS letter
- Collective bargaining agreement(s)
  - Provides for the establishment of a trust and its purpose
  - Determines the contribution requirement

Key Plan Documents

- Annual Audited Financial Statements
- Policies of Insurance
- Summary plan description/certificates of insurance
- Minutes of meetings
- Written contracts with all vendors

Key Plan Documents - Policies

- Policies and Procedures
  - Collection
  - Investment
  - Trustee Education and Expenses
  - Code of Conduct/Ethics
  - HIPAA/ Privacy Protections/Security
  - Employee Handbook
  - Harassment/Non-Discrimination
  - Social Media/Electronic Communication/Use of I.T.
  - Whistle Blower

Part 3. Fiduciary Standards

- Who is a fiduciary?
- What is the standard of care for fiduciaries?
- What are the penalties for breaching your fiduciary duties?
- Can you delegate fiduciary duties and how?
- When might one fiduciary be liable for the breach by another?

Who is a Fiduciary?

- ERISA requires that plans name one or more fiduciaries in their written documents.
- Named fiduciaries are generally the plan administrator and plan trustees.
- Others may be functional fiduciaries to the plan if their function or conduct falls within the definition of fiduciary.

Definition of a Fiduciary, ERISA, Section 3(21)A

“. . . a person is a fiduciary with respect to a plan to the extent (i) he <u>exercises any discretionary authority or discretionary control</u> respecting management of such plan or exercises any authority or control respecting management or disposition of its assets;

Definition of a Fiduciary, ERISA, Section 3(21)A *(Continued)*

(ii) he <u>renders investment advice</u> for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so,

or

Definition of a Fiduciary, ERISA, Section 3(21)A *(Continued)*

(iii) he has any <u>discretionary authority or discretionary responsibility in the administration</u> of such plan."

Two Hats

- Fiduciaries may wear two hats, <u>e.g.</u>, may be employer or union representatives.
- When acting as Trustees, you must act for the <u>exclusive</u> benefit of plan participants, not in your own interest or in the interest of your employer or your union.

McCaffree Financial Corp. v. Principal Life Ins. Co., 2016 WL 98332, --- F.3d ---- (8th Cir. Jan. 8, 2016).

- Eighth Circuit held that financial advisor for employee retirement benefit plan could not be liable for breach of fiduciary duties for excessive investment management fees because fee structure that was alleged to be excessive was agreed to in contract between financial advisor and plan sponsor.
  - An outside party is not a fiduciary of a plan simply by negotiating terms for providing services to that plan
  - After entering into the agreement, the advisor could be a fiduciary

McCaffree Financial Corp. v. Principal Life Ins. Co., 2016 WL 98332, --- F.3d ---- (8th Cir. Jan. 8, 2016).

- In this case, the allegation was based on the advisor charging an "account" fee on top of mutual fund fees that it also charged.
  – Because the plan sponsor agreed to this layering of fees, and the layering was the sole basis for the claim, the financial advisor was not liable as a fiduciary for this fee structure.

Think About

- Are you a named fiduciary?
- Are you a functional fiduciary?
- Are you both?
- Why?
- How about your professional advisors? Are they fiduciaries? Some of them? All of them?
- What about the collective bargaining parties?
  - Is the union a fiduciary?
  - Is the employer a fiduciary?

Examples

- Trustees, the Plan Administrator, and Investment Managers are generally fiduciaries.
- Those who are generally not fiduciaries:
  - Accountants
  - Actuaries
  - Attorneys
  - Health Providers
- The decision as to who is and who is not a fiduciary is quite fact specific.
- Note: The New DOL Fiduciary Rule (and the possible delay in its implementation will be discussed later).

What is the Fiduciary Standard of Care?

A. Duty of Loyalty and its corollary, the Exclusive Benefit Rule
B. Duty of Care/Prudence
C. Duty to Diversify Plan Investments
D. Duty to Act in Accordance with Plan Documents
E. Duty to Avoid Prohibited Transactions
F. Duty With Regard to Co-Fiduciaries

General Fiduciary Obligations, ERISA, Section 404(a)(1)

"(a) Prudent Man Standard of Care.—

(1) . . . A fiduciary shall discharge his duties with respect to a plan **solely in the interest** of the participants and beneficiaries and—

General Fiduciary Obligations, ERISA, Section 404(a)(1) *(Continued)*

(A) for the **exclusive purpose** of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

General Fiduciary Obligations, ERISA, Section 404(a)(1) *(Continued)*

(B) 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;

General Fiduciary Obligations, ERISA, Section 404(a)(1) *(Continued)*

(C) by **diversifying** the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

General Fiduciary Obligations, ERISA, Section 404(a)(1) *(Continued)*

(D) **in accordance with the documents and instruments governing the plan** insofar as such documents and instruments are consistent with the provisions of this title and title IV."

Enhanced Prudent Man Role

- If you don't have the expertise, seek it.
- Fail to do so at your own peril!

Prohibited Transactions—ERISA § 406

- In addition to breaches of fiduciary duties, fiduciaries are prohibited from engaging in certain transactions known as "prohibited transactions." Engaging in these transactions would also be a breach of fiduciary duty as well as a prohibited transaction subjecting the fiduciary not only to the remedies described above, but also to excise taxes. Prohibited transactions can be basically broken down into two categories:
  1. Party in interest transactions
  2. Self-dealing transactions

Prohibited Transactions—Party in Interest

- Party in interest includes:
  - Plan fiduciary, counsel or employee
  - Service provider
  - Contributing employer
  - Employee organization whose members are covered (i.e., union)
  - Employee, officer, director or 10% shareholder of a fiduciary, the union or a contributing employer
  - Certain other relative, owners or entities owned by a party in interest

Party in Interest Transactions—ERISA §406(a)

- A fiduciary cannot cause the plan to engage in a transaction if he knows or should know that it is a direct or indirect:
  - Sale or exchange, or leasing, of any property between the plan and a party in interest;
  - Lending of money or other extension of credit between the plan and a party in interest;
  - Furnishing of goods, services, or facilities between the plan and a party in interest;
  - Transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or
  - Acquisition by the plan of employer securities or real property

Self Dealing Transactions ERISA § 406(b)

- A fiduciary cannot:
  - Deal with the assets of the plan for 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 the interests of the plan or the interests of its participants or beneficiaries; and
  - Receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

Prohibited Transaction Exemptions (PTEs)

- There are certain transactions that are exempted from the prohibited transaction sections of ERISA. These exemptions are provided by:
  - Statute
  - Class exemptions
  - Individual exemptions

PTEs—Delinquent Contributions

- Prohibited Transaction Class Exemption 76-1
  - Arrangement to delay receipt of contribution is allowed if:
    - Plan made an effort to collect
    - Terms of extension are in writing
    - Arrangement to extend collection time is for the exclusive purpose of facilitating collection

PTEs—Delinquent Contributions

- Plan can agree to accept less than the whole contribution if:
  - Plan made reasonable, diligent and systematic efforts to collect the contribution
  - Terms of agreement are in writing
  - Terms of agreement are reasonable under the circumstances based upon the likelihood of collecting the contribution or the expense that would be incurred if the Plan continued to attempt to collect the contribution

PTEs—Delinquent Contributions

- Plan can deem contributions uncollectible if:
  - Prior to the determination, plan made reasonable, diligent and systematic efforts as are appropriate under the circumstances to collect
  - Determination is in writing
  - Determination is reasonable and appropriate based on the likelihood of collecting the contribution or the approximate expenses if the plan continued to collection efforts

PTEs—Delinquent Contributions

- Takeaways
  - Adopt a written policy covering audits
  - Adhere to the policy
  - Review the policy periodically to ensure that it remains reasonable
  - Document decisions to make changes to the policy – how do we justify the level of effort
  - In specific cases, ensure that there is a reasoned, independent decision made in each case about how to proceed, when to settle and when to write off
  - Document the efforts to collect, decisions and reasons in those cases!

PTEs—Service Providers

- Section 408(b)(2) allows contracts or arrangements with a party in interest to provide services (or ancillary goods) or office space to the plan if:
  - Necessary for the establishment or operation of the plan
  - No more than reasonable compensation is paid
  - Contract or arrangement is reasonable
    - Must be terminable by the plan on reasonably short notice under the circumstances
    - Certain covered service providers of covered (pension) plans must disclose compensation-related information to a responsible plan fiduciary if the covered service provider reasonably expects over $1,000 in compensation

PTEs—Service Providers

- Takeaways
  - Make sure you document why you are hiring a service provider so it is clear that the service is necessary
  - Review compensation when you hire the provider and on an ongoing basis to ensure that it is reasonable
    - If the provider makes disclosures, review those disclosures
    - Note: plan does not have to accept the lowest bid!—DOL Informal Letter to SEIU regarding selection of health care providers (2/19/98)
  - Never enter into an arrangement until you are sure that no disclosure is required or that you received full disclosure

PTEs—Service Providers

- Make sure the contract is terminable on reasonably short notice without penalty
- Make sure the other terms of the arrangement are reasonable
  - DOL Adv. Opinion #2002-08A addresses attempts of service providers to limit liability and the process for selection of service providers.
- Review service providers on an ongoing basis
  - DOL Regulations § 2509.75-8, Q&A FR-17—The performance of service providers should be reviewed at reasonable intervals

Office Space

- Two common prohibited transactions
  - Leasing between a plan and a PII (union, related plan, employer association)
    - Another plan may or may not be a PII (e.g., is it a contributin employer to the other plan, does it provide services to the other plan?)
  - Conflicts of interest for trustees
    - Same group of trustees decides the rent that one plan pays to another
    - Trustees is also head of the union or association to which space is leased
- Multiple PTEs depending on the particular parties, type of space, and who is leasing to whom

Office Space

- Takeaways:
  - Make sure that there is an exemption for the particular transaction and understand what it covers
    - Consider recusals where needed
  - Make sure reasonable compensation requirements are met
    - Out of date appraisals are a big problem area
  - Be able to demonstrate that the terms were at least as favorable to the plan as an arm's length transaction with an unrelated party or are reasonable
  - Document it—have a written lease, maintain records, document above determinations.
  - Note similar issues with shared employees.

What are the Penalties for Breaching Your Fiduciary Duty?

Personal Liability for Breach, ERISA, Section 409(a)

"(a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach,

Personal Liability for Breach, ERISA, Section 409(a) *(Continued)*

and to restore to such plan any profits of such fiduciary which have been made through the use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary."

Can Fiduciary Duties Be Delegated?

- A qualified yes, but
  - Plan document must allow for such delegation or allocation of fiduciary duties (other than trustee responsibilities.)
  - Delegation should be in writing
  - Remember ongoing duty to monitor

Duty of Prudence

- The use of professional advisors does not relieve the fiduciary from exercising prudence in decision-making.
- On a day-to-day basis, this obligation requires ongoing attention to the business of the fund; regular attendance at meetings; careful reading of correspondence from the administrator and fund professionals; and review of meeting minutes and other plan documents.

Duty of Prudence *(Continued)*

- In Schoenholtz v. Doniger, 628 F.Supp. 1420 (S.D.N.Y. 1986), the court concluded that a trustee violated his fiduciary duties by failing to attend trustee meetings.
- Fiduciaries cannot simply "rubber stamp" the decisions of other trustees or rely blindly on the advice of professionals. "A pure heart and an empty head are not enough" to satisfy the Duty of Prudence. Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983).

When Might One Fiduciary Be Liable for the Breach by Another?

- A fiduciary . . . shall be liable for a breach of fiduciary responsibility of another fiduciary . . .
  – He participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;

Co-Fiduciary Liability *(Continued)*

– If by his failure to comply with the specific responsibilities which give rise to his status as fiduciary, he has enabled such other fiduciary to commit a breach; or

– If he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

Hypothetical—
Co-Fiduciary Liability

- Assume that you become aware that a fellow trustee has entered into a business venture with the plan's investment consultant.
- The trustee routinely votes on the consultant's contract and whether to bid out consulting services, but he never reveals his business relationship with the provider.
- What should you do? Do you have any liability?

Co-Fiduciary Liability *(Continued)*

- A plan fiduciary is not relieved of responsibility for the fiduciary breaches of another fiduciary simply because he or she is not committing the breach.
- The fiduciary who discovers the breach of another must take affirmative action to remedy the problem, or she/he could face liability for the fiduciary breach himself.

Co-Fiduciary Liability *(Continued)*

- This action may include reporting the matter to the full board and demanding remedial action.
- If no action is taken by the board, the fiduciary then must consider whether the matter should be reported to the appropriate authority.
- Resignation from the board without taking any remedial action is generally not enough to shield the fiduciary from liability for the breaches of other board members.

Recap: Fiduciary Standards

A. Duty of Loyalty and its corollary, the Exclusive Benefit Rule
B. Duty of Care
C. Duty to Diversify Plan Investments
D. Duty to Act in Accordance with Plan Documents
E. Duty to Avoid Prohibited Transactions (conflicts of interest)
F. Duty With Regard to Co-Fiduciaries

And, of course, comply with applicable law!

DOL's New Fiduciary Rules

- April 6, 2016: DOL issued the final "Conflict of Interest" regulations
  - Redefines and expands who is classified as an **"investment fiduciary"** under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries.
  - Significance of new rule:
    - If investment fiduciary, the person must act in participant's best interest, avoid engaging in prohibited transactions and charge only reasonable fees.

DOL’s New Fiduciary Rules

- Replaces regulations originally issued in 1975.

  - DOL viewed old rule requiring that advice be made “on a regular basis” and be “the primary basis for a decision” to be too narrow.

  - Many investment advisors could avoid fiduciary responsibility under old rule.

- Reflects evolution from DB plans to DC plans where individual participants are investing their own retirement assets.
- Phased-in implementation begins April 2017 and full effect by January 1, 2018.
- There are current attempts to delay or change the rule so stay tuned.

DOL's New Fiduciary Rules

- Classified as an investment fiduciary if the person provides covered investment advice in the form of a recommendation:
- Recommendation: Communication reasonably viewed as suggesting specific action.
  - The more tailored the suggestion, the more likely it will be viewed as a recommendation.
- Person providing the recommendation must receive a fee or other compensation for it.

DOL's New Fiduciary Rules

- Covered Investment Advice: Recommendation consists of "covered investment advice."
  - Buying, holding, selling or exchanging securities or other investment property.
  - How securities should be invested after rollover to an IRA.
  - Management of securities, including investment policies or selection of investment providers.
  - Whether to take a rollover, transfer or distribution from a plan or IRA.

DOL's New Fiduciary Rules

- <u>Fiduciary Relationships</u>: Recommender has relationship with the plan, a plan fiduciary, or a plan participant.
  - Provides specific advice about specific investment with respect to plan assets.
  - Pursuant to agreement that advice is based on particular needs of recipient.
  - Represents or acknowledges himself as fiduciary under ERISA or Internal Revenue Code.

DOL's New Fiduciary Rules

- Communications that are not recommendations.
  - Making available a platform of investment alternatives.
  - Responding to RFPs.
  - Providing objective financial data comparisons with independent benchmarks.
  - General communications, *e.g.*, newsletters, commentaries, general retirement and financial planning.

DOL's New Fiduciary Rules

- Investment education.
  - Does not reference appropriateness of individual investment alternative, individual benefit distribution options.
  - Does not address specific plan investments, products, alternatives, options or services.
- Takeaway:
  - Some investment advisors who were not plan fiduciaries may now be classified as investment advice fiduciaries.
  - Trustees may have recourse against third parties who will now be deemed to be investment advice fiduciaries.

Part 4. Service Providers

A. Attorney
B. Accountant
C. Consulting/Actuarial Firm
D. Administrator/TPA
E. Insurer(s)
F. Bank/Custodian
G. Investment Consultant and Managers
H. IT Consultants and Others

Selecting and Monitoring Service Providers

The DOL has published tips for selecting and monitoring service providers:

- Consider what services the plan needs.
- Ask for relevant information from the service providers being considered (scope of services, experience, fees, references, etc.)
- Provide all prospective service providers identical and complete information about the needs of the plan. Consider formal bids from those best suited to the plan's needs.
- Consider "bundled services".
- Require each prospective provider to specify which services are covered for the estimated fees and which are not. Compare all the information received including that on fees and expenses.

Selecting and Monitoring Service Providers

- Ensure that any provider handling plan assets has a fidelity bond.
- Check with state or federal licensing authorities to confirm the provider has an up-to-date license (if required) and whether there are any complaints pending against the provider.
- Make sure you understand the fees and expenses and the other terms of any agreements you sign with service providers and that such fees and other terms are reasonable.

Selecting and Monitoring Service Providers

- Document in writing the process followed and the reasons for selecting the provider.
- Require the provider to provide regular information or other reports about the services provided.
- Periodically review the provider's performance for quality and at a cost consistent with the arrangement.
- Review participant comments and complaints and periodically ask for verification that information received is still valid.

Questions?

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