OSLER

The Intelligent Fiduciary: Common Problems You Can Avoid

Carol Buckmann, Counsel, Osler, Hoskin & Harcourt LLP, New York

February 19, 2015

www.pensionsbenefitslaw.com

OSLER

Are You a Fiduciary?

- You may be a fiduciary and not know it. Acknowledgement of fiduciary status is not required.

- A fiduciary has discretion or control over plan assets or administration, or gives investment advice for a fee

- Settlor v. fiduciary functions
  - Ministerial jobs do not trigger fiduciary liability--benefit calculations, tests
  - <u>Geopharma</u> case blurs the line

- Implementing settlor decision may be a fiduciary act.

- If no other fiduciary is appointed, the plan sponsor and its Board members are default fiduciaries

Special Roles

- Trustee Responsibilities
  - Cannot be delegated
  - U.S. qualified plans must have U.S. bank or trust company or decisions made by U.S. persons – domestic trust requirement

- Named Fiduciaries under ERISA
  - Provide for in plan document
  - Disperse responsibilities

- Investment managers

- Third party administrators (TPAs)
  - May or may not be fiduciaries. Distinguish discretion from recordkeeping
- Board of Directors of plan sponsor always has residual fiduciary functions-can't outsource everything

TIP: Avoid problems. Know whether your TPA is a fiduciary.

OSLER

Are Your Vendors Fiduciaries?

- Investment adviser or broker? Tiblier v. Dlabal
  - This makes a BIG difference-brokers are subject only to suitability standard
  - Fiduciaries must put participant interests first
  - Know the difference between RIA fiduciaries and ERISA fiduciaries
  - Tiblier Court said adviser can't be a fiduciary unless paid by plan
  - The five part test for investment advice and possible changes
- 401(k) Vendors
  - Leimkuehler and Santomenno cases-not fiduciaries
  - Mass Mutual -can be fiduciaries
  - "Product design" isn't a fiduciary function

TIP: Avoid "Teflon fiduciaries." Your investment adviser should acknowledge ERISA fiduciary status in writing.

OSLER

What about professional advisers?

- Lawyers, accountants and actuaries performing their usual roles are not fiduciaries. They may be advising plan sponsor in its settlor role.

TIP: Avoid improper use of plan assets. If advising settlor, do not pay their fees out of plan assets.

OSLER

Basic Fiduciary Duties

- Prudent expert standard under ERISA
- Diversification (unless it's prudent not to do so)
- Avoiding prohibited transactions with related parties and self-dealing
- Follow plan terms
  - But what happens if plan pays the wrong amount?
  - Gabriel case, Guerra-Delgado case, EPCRS provide guidance (but see Bloemker v. Local 265 Pension Fund for an estoppel case the participant won)
- Operate plan solely in the interest of participants and beneficiaries
- "Safe Harbors" can protect fiduciaries
  - Participant- directed investments, default investments, selection of annuity providers
- Co-fiduciary and successor liability

TIP: Schedule a fiduciary education session.

Limits on Fiduciary Responsibility

- Only to the extent performing fiduciary functions
  - For example, a member of the Administrative Committee who is not on the Investment Committee is not responsible for investment decisions
- Personal liability only for losses connected to the breach of fiduciary duty
  - Supreme Court in CIGNA v. Amara held that equitable relief (reformation, surcharge, estoppel) is available.
- Well-drafted plan documents and company charters can clearly define responsibilities and avoid overlapping functions
- BUT NOTE: Disclaimers will not work if you are acting as a fiduciary-functional definition

OSLER

OSLER

Plan Committees

- Usually a Named Fiduciary under Section 402 of ERISA
- Board remains responsible only for prudent appointment and monitoring after full delegation
- Committees can be responsible for administration and/or investments
- Administrative committees are usually responsible for general compliance, including reporting and disclosure, non-discrimination testing, required amendments, claims review
- Investment committees are usually responsible for selecting managers or plan funds

- TIP: Make sure that your plan documents are adopted by the right fiduciaries

The Best Committees

- Have a Charter or specific plan provisions establishing powers and duties
- Consist of members with specific competence: "A pure heart and an empty head are not enough"
- Understand how to review fees and share classes, and the importance of paying reasonable fees
- Make sure the right party is acting
- Hire the right professional advisers and have them present to report and answer questions at meetings
- Appropriately delegate to HR and Finance, but understanding that this does not remove committee responsibility

OSLER

TIP: Special issues arise when parent and subsidiary share responsibilities.

- Retaining right to approve
- Discretion to take necessary action
- Need for clear charters/by-laws where there are parent and sub committees

The Best Committees (cont.)

- Have an investment policy statement and follow it
  - Tussey v. ABB
- Meet regularly
- Leave the right paper trail
  - Agendas, formal minutes setting forth the reasons for decisions
- Establish good internal controls
- Hire good advisers
- Understand that plan communications need careful review.
  - Distributing misleading or fraudulent communications is a fiduciary breach (CIGNA v. Amara)

TIP: Schedule an ERISA governance review.

OSLER

Hiring Independent Fiduciaries

- Professional fiduciaries may be hired to represent plan participants where corporate officers would have a conflict of interest
- Typically hired when plans hold company stock
  - Purchase or tender offer
  - ESOP stock purchases
  - Determining when to eliminate stock fund
- NOTE: the U.S. Supreme Court recently held in Dudenhoeffer that ESOP stock investments are no longer subject to a presumption of prudence

OSLER

OSLER

Hiring Independent Fiduciaries (cont.)

- Used or required in some prohibited transaction exemptions
- Also have been used in de-risking transactions- annuity purchases
- May be used to decide whether plan should enter into settlement agreements
- Provides protection against agency action and participant lawsuits

TIP: Make sure to investigate fiduciary's qualifi- cations and certifications.

Fiduciary Liability Insurance

- Don’t confuse it with the required ERISA bond or executive liability (D&O) insurance
- ERISA bond provides recovery to plan if there is a loss due to fraud or embezzlement-won’t reimburse fiduciaries
- Fiduciaries should not rely on D&O insurance-typically does not cover acting as a fiduciary
- Indemnification is not a good alternative
  - Plan assets may not be used to indemnify fiduciary for breach of duty
  - Employer indemnification may be limited by law or meaningless if employer in financial distress

OSLER

Liability Insurance Issues

- Must be a third party claim
- Third party service providers will not be covered- not employees or directors
- May have to add a rider to cover committee
- What is wrongful act?
- Is there a fraud exclusion? (CIGNA case)
- Who picks counsel and how are defense costs handled?
- Are errors in administration covered?
  - Optional voluntary correction program coverage in absence of a claim
  - Are corrective benefit payments excluded?

TIP: Review your coverage with an expert.

OSLER

Activity to Monitor

OSLER

- Both the Department of Labor and the SEC are considering proposals to broaden fiduciary responsibility of brokers and others.
- Controversial Department of Labor proposal (since withdrawn) would have eliminated part of five part test for investment advice
- Dodd Frank Act directed the SEC to consider one standard of liability for brokers and registered investment advisers
- We don't yet know when or whether they will act.
- Watch for U.S. Supreme Court decision in Tibble-will determine whether duty to monitor and review investments is limited to six years
- Watch for possible changes re: de-risking responsibilities
    - new PBGC reporting.

Questions?

- Carol Buckmann
- cbuckmann@osler.com
- 212-991-2581

- Sandra Cohen
- Sandra.cohen@osler.com
- 212-991-2508

OSLER

U.S. Tax (IRS Circular 230):
Any U.S. tax or other legal advice in this communication (including in any attachment) is not intended and is not written to be used, and it cannot be used, by any person to (i) avoid penalties under U.S. federal, state or local tax law, or (ii) promote, market or recommend to any person any transaction or matter addressed herein.