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Current Fiduciary Issues: The Song That Never Ends

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Today's Agenda

- Current ERISA definition of fiduciary: who is "in" and who *may be* "out"
- Key fiduciary duties
- Appointment and monitoring of fiduciaries and other providers
- Special fiduciary risks of company stock as a DC plan investment
- Proposed DOL changes to the definition of fiduciary and how they may impact plan sponsors, providers and consultants

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Who Is a Fiduciary Under ERISA?

You are a fiduciary under ERISA to the extent you are either

"Named" as a fiduciary
(you are officially designated as a fiduciary)

OR

"Deemed" to be a fiduciary
(you satisfy the ERISA section 3(21)(A) definition)

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How Do I Get Deemed or Named an ERISA Fiduciary?

The fundamental definition of a fiduciary under ERISA

ERISA section 3(21)(A): a person is a fiduciary with respect to a plan to the extent he/she

- **Exercises any discretionary authority or control over plan management**
- **Exercises any authority or control over plan assets**
- **Renders, or has any authority or responsibility to render, investment advice for a fee**
- **Has any discretionary authority or responsibility over plan administration**

Fiduciaries can also be named as investment managers under ERISA 3(38)

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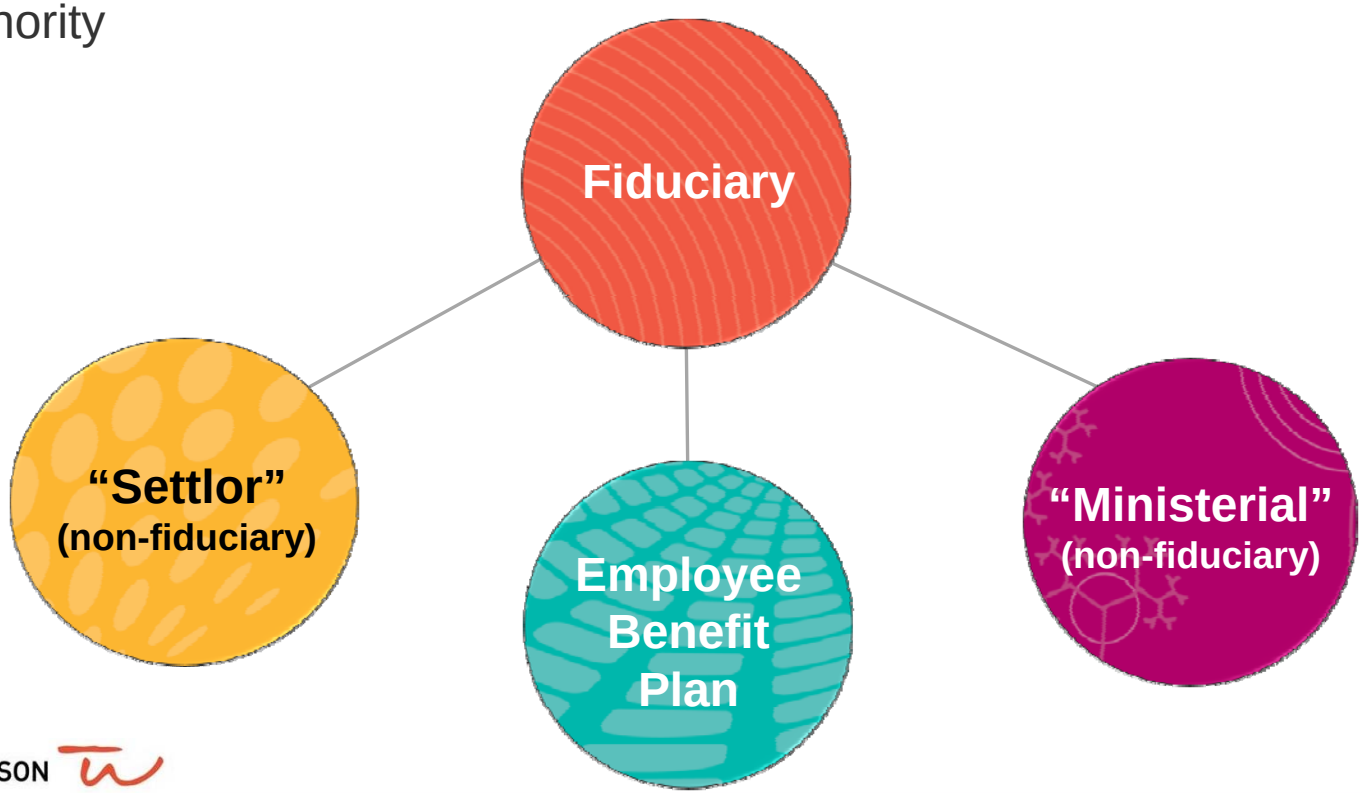
Categories of Plan-Related Actions, Decisions, Tasks

- Actions may be fiduciary, or "settlor" or "ministerial" non-fiduciary actions, and status often depends on nature of action and degree of discretionary authority



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Categories of Plan-Related Actions, Decisions, Tasks

Decisions/activities/tasks can generally be divided into three categories

Investment-related (fiduciary or ministerial)	Administration-related (fiduciary or ministerial)	Design-related (normally, settlor)
e.g., selection/monitoring of assets and fund lineups, investment policy, selection/monitoring of Investment service providers, payment of fees and expenses	**e.g., selection/monitoring of recordkeepers, consultants and other service providers, plan interpretation, claims adjudication, compliance with reporting, disclosure and other requirements**	**e.g., establishing plans, determining plan features including benefit or contribution formulas, amending plans, terminating plans**

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Who Are Fiduciaries?

- Plan Administrators – Named Fiduciaries
  - Set forth expressly in the plan documents
- The Sponsor's Board (limited duties to monitor and appoint)
  - The right to appoint plan administrators (both an employee benefits committee or a plan investment committee) creates the fiduciary duty for the Board to monitor performance of fiduciaries
  - Delegates by the board who are given fiduciary authority
- *De facto* fiduciaries include those who exercise discretion or control plan assets.
  - Plan sponsor employees who communicate with participants regarding plan benefits, particularly if employee is in the benefits department, can be deemed to be fiduciaries

Who Are Fiduciaries? (cont.)

- Entities controlling plan assets:
  - The trustee is normally treated as a fiduciary.
    - DOL limits fiduciary duties of directed trustees.
- Investment Managers and Advisors. DOL has proposed new fiduciary rule that is more expansive in designation of fiduciaries, with additional duties
- TPA which sets its own compensation from plan assets
- Nonfiduciaries can be liable for equitable relief under ERISA
  - *Harris Trust*: liability is under ERISA § 502(a)(3)
  - Ordinarily, service providers, such as attorneys, actuaries, appraisers and accountants, are do not perform fiduciary functions, but only ministerial services. See 29 C.F.R. § 2509.75–5, D-1, Q & A

Significance of Actions Being Ministerial and Not Fiduciary

- Not an ERISA fiduciary, not subject to the prudent man standard of care, and errors and omissions would not normally constitute breaches of fiduciary duty under ERISA
- Other plan fiduciaries would not normally be implicated as co-fiduciaries regarding the error or omission
- Reasonable and appropriate fees and expenses relative to the performance of ministerial functions are payable from plan assets

Key Fiduciary Duties

- ERISA requires fiduciaries to act with:
  - Prudence
  - Loyalty
  - Disinterestedness – acting in the sole interest of participants
  - Compliance with terms of the plan, unless otherwise imprudent
- ERISA requires fiduciaries to preserve plan assets
  - ERISA imposes express statutory and regulatory duties to pay only “reasonable” compensation from plan assets

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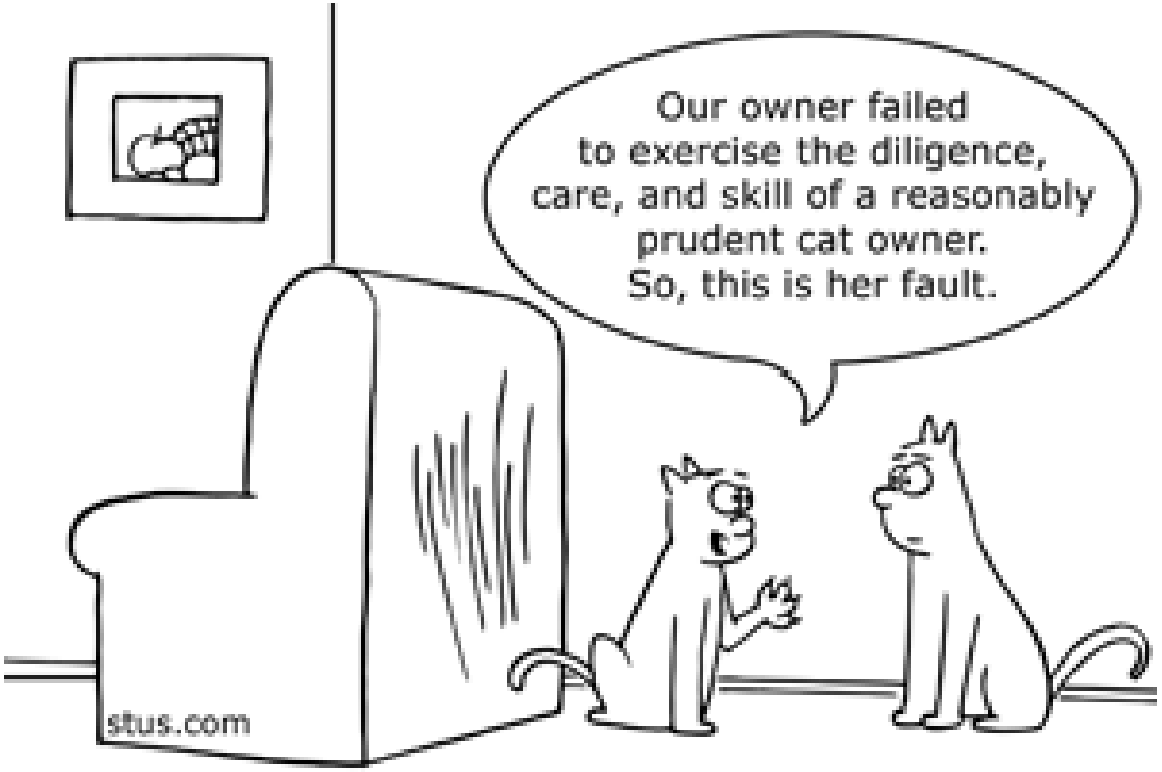
Appointment and Monitory of Fiduciaries: What Being a Prudent Fiduciary under ERISA Really Means…



Duty to Monitor Investments
Tibble v. Edison Int'l., 135 S. Ct. 2459 (May 18, 2015)

- **Background:** Edison's 401(k) plan offered three retail mutual funds in 1999 and another three retail mutual funds in 2002. The six retail mutual funds had higher management fees than otherwise identical institutional mutual funds that the plan fiduciaries could have, but did not, use. Plan expenses were covered in part through fee sharing. The 401(k) plan also contained a unitized employee stock fund and short-term investment fund.
- **Lawsuit:** In 2007, suit was filed to seek (i) damages for investment drag in the unitized fund, (ii) losses for inadequate returns in the short-term investment fund, (iii) damages due to allegedly excessive fees paid through fee sharing and (iv) damages due to the allegedly excessive fees charged by the six retail mutual funds.
- **District Court Decision:** The district court granted judgment for the Plan's fiduciaries on all claims, except the excessive fees in the retail mutual funds. Holding that ERISA's six-year statute of repose barred the 1999 retail mutual fund claims, the court awarded damages of $370,000 on the fee claims involving the three 2002 retail mutual funds.
- **Ninth Circuit Decision:** The Ninth Circuit affirmed the district court's judgment holding *inter alia* that because the "beneficiaries' trial claims hinged on infirmities in the selection process for investments," the 1999 retail mutual fund claims were time-barred.

Tibble v. Edison Int'l., (cont.)

- **Issue:** The sole issue before the Supreme Court was whether ERISA's limitations/ repose provisions barred fiduciary breach claims predicated on investments selected more than six years before suit, *i.e.*, did ERISA's six-year statute of repose apply?
- **Decision**: Justice Breyer's unanimous decision vacated Ninth Circuit's limitations decision based on the holding that fiduciaries have a continuing duty to monitor investments even after their initial selection.
- **Principal Holdings**:
  - "Under trust law, a **trustee has a continuing duty to monitor trust investments and remove imprudent ones**. This continuing duty exists separate and apart from the trustee's duty to exercise prudence in selecting investments at the outset."
    - Duty to monitor continues as long as investment is in 401(k) plan.
  - "The **trustee must systematically consider all the investments of the trust at regular intervals to ensure that they are appropriate**."
  - If "**trust estate includes assets that are inappropriate** . . ., the **trustee is ordinarily under a duty to dispose of them within a reasonable time**."
    - Otherwise good investments can be imprudent if the fees are excessive.

Tibble v. Edison Int'l., (cont.)

- Action steps:
  - Fiduciaries must engage in a reasonable process in selecting and monitoring investments, including evaluating expenses and fees.
  - Fiduciaries must regularly monitor investments for prudence, including fees and expenses.
    - Regular monitoring of all fiduciary arrangements, including trust arrangements and service contracts.
      - Developing case law will inform fiduciaries as to how and how often monitoring is required, *e.g.*, Seventh Circuit requires review of RFP's for service providers every three years.
  - Critical is **documentation** of the process fiduciaries employ in making investment and other decisions.
    - The DOL now recognizes that "[o]ne way fiduciaries can demonstrate that they have carried out their responsibilities properly is by documenting the processes used to carry out their fiduciary responsibilities."
    - If fiduciaries' reasoning process is not documented, it did not occur.

Scope of Monitoring Duty Not Reached by Supreme Court; Lower Courts May Look to Trends

- The Supreme Court did not address the more difficult question regarding the scope of the fiduciaries' duty and remanded the litigation to the Ninth Circuit to determine whether the they actually breached their fiduciary duties by maintaining the retail class mutual funds
  - The Court also left open the potential for the Ninth Circuit to dispose of the older claims on technical grounds without a further substantive decision
- Many decisions on fee litigation suggest that the continued offering of a share class that is more expensive *due to revenue sharing* is not a *per se* violation of fiduciary duties so long the choices have prudently been considered, and there is documentation to defend the decision

Trends are to

Revenue sharing itself is not "bad"; *not* "managing" and "negotiating it" is

- Monitor investments quarterly or semi-annually and upon a major "event"
- Negotiate record keeping fees every three years and upon a major "event"
- Capture and use and often reduce and eliminate revenue sharing
- Allocate recordkeeping fees per capita
- Document all decisions considered

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DC Fee Litigation: Key Settlements and Pending Suits

Fifteen settlements with employers ($ millions) and a variety of agreements, including to conduct competitive recordkeeping RFPs, commit to per capita recordkeeping fees, avoid retail funds and consider collective trusts

- *Boeing* ($TBA), *Lockheed* ($62), *Cigna* ($35), *International Paper* ($30), *Transamerica* ($28), *Ameriprise* ($27.5), *Bechtel* ($18.5), *Caterpillar* ($16.5), *General Dynamics* ($15), *ING* ($15 million), *Wal-Mart* ($13.5), *Fidelity*, ($12), *Kraft* ($9.5), *Principal* ($3) and *RadioShack* ($2.4)

Several settlements with providers ($ millions) and agreements to change their products to remove discretion, including

- *Nationwide* ($140), *TIAA-CREF* ($19.5), *MassMutual* ($9.5*), Hancock, Hartford and ING*

Pending Lawsuits	Status
Northrup Grumman	• Fee and investment class claims pending with only procedural actions since November, 2014
Novant Health	• Filed March 2014, alleging revenue sharing based fees increased 10x's within 3 years
State Farm	• Revenue sharing paid from target date funds challenged
Tibble v. Edison International	• Briefing underway on standards for ongoing monitoring and how that impacts share class choice
Great West, JP Morgan, Transamerica	• Suits pending against Great West, JP Morgan and Transamerica as providers, alleging conflicts of interest and/or excess fees

Welfare Plan Fee Issues: *Hi-Lex*

- Sixth Circuit recently held that a third-party administrator functioned as fiduciary for an employer's health plan because TPA's fees were discretionarily imposed, and TPA held plan assets to pay the healthcare expenses of plan beneficiaries *Hi-Lex Controls, Inc. v. Blue Cross Blue Shield of Michigan*, 751 F.3d 740 (6th Cir. 2014), *cert. denied*, 135 S. Ct. 404 (2014)
- Sixth Circuit held that common law supported conclusion that TPA held funds wired by employer "in trust" for purpose of paying plan beneficiaries' health claims and administrative costs
- Plan sponsors need to review fee arrangements with PBM's and TPA's to understand and approve fee arrangements

Special Risk Characteristics of Company Stock

- When company stock prices go down, "stock drop" suits often follow
- Company stock funds – and other funds made up of single company equities – contradict the principles that are typical of funds in DC plan menus designed with a view to good governance practices
  - In the past, DC plan fiduciaries could rely on the judicially created "presumption of prudence" from *Moench v. Robertson* to justify the company stock investment option – the Supreme Court struck down the "presumption of prudence" in *Fifth Third v. Dudenhoeffer*
- Most DC plans offer a "core menu" of diversified funds that pool securities
  - Single company stocks are inherently undiversified
- Better practice is for DC plan funds to be selected and monitored against stated benchmarks with support from an independent consultant
  - It has not been typical for company stock funds to have a stated benchmark
  - We believe it has been typical for most DC plan investment consultants to limit their advice on single company stock funds to encourage fiduciaries to consider their elimination
    - Note, however, the 4th Circuit's decision in Tatum v. RJR (cert.denied) which held that fiduciaries can be held liable when they divest company stock fund and the stock value increases absent good procedural steps

Employer Stock Drop Cases: *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014)

- **Holding**: Supreme Court rejected "presumption of prudence" for ESOP fiduciaries because "the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries, except that an ESOP fiduciary is under no duty to diversify the ESOP's holdings."

- **Three new principles limit, but do not eliminate, ERISA "stock drop" claims**:
  - "where a stock is publicly traded, allegations that a fiduciary should have recognized from publicly available information alone that the market was over- or undervaluing the stock are implausible as a general rule, at least in the absence of special circumstances"
    - Public company ESOP claims involving stagnant or dropping stock prices, based on public information allegations, hard, if not impossible, to maintain.
    - What constitutes "special circumstances" will require judicial development by lower courts.
  - ESOP fiduciaries may not consider non-public or insider information.
  - A stock drop claim must be able to identify a fiduciary action that will not injure the plan by itself lowering the price of the employer stock.

Employer Stock: *Dudenhoeffer* (cont.)

- **Action steps**:
  - ESOP fiduciary should document review of plan language authorizing company stock in light of *Dudenhoeffer* to demonstrate fiduciary's understanding and application of legal principles relevant to employee stock investments.
  - ESOP fiduciary should document that no "special circumstance" exists as to company stock.
  - ESOP fiduciary should consider deletion from SPD any reference to SEC filings.
  - ESOP fiduciary should document ongoing review of employer stock performance, particularly to extent that company match in employer stock is not immediately tradable by plan participant.

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Key findings from TW Company Stock Flash Survey

76%

have reviewed or **plan to review** their **procedures** for **monitoring** company stock
Of those that have **completed reviews**, **37%** have **revised** their procedures

74%

have reviewed or **plan to review** their **investment policy** statement
Of those that have **completed reviews, 41%** have **revised** their statements

62%

have **reviewed** or **plan to review** their **plan document**

Of those that have **completed their reviews, 27%** have made **plan amendments**

38% have retained or are considering retaining a **third party** as an **independent fiduciary** with specific responsibility for **monitoring company stock** as an investment choice

32% do not allow or restrict future investment in company stock

26% of sponsors have initiated or are considering the initiation of procedures to **eliminate company stock**

13% of survey respondents have been sued in a “stock drop” suit

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A Synopsis of "Stock Drop" Litigation

- Over 160 "stock drop" suits filed since 2004 and over 160 reported settlements since 1997
- Suits and settlements declined from 2012 to 2014 as several courts granted dismissals based on a presumption of prudence
- *Fifth Third* decision has changed that, and several suits have been filed since then including against Kodak, IBM and RadioShack, while other suits have continued to move forward such as those against Amgen, BP and JC Penny
- Two strains of cases seem to be developing and keep moving forward
  - "Classic insider" allegations that fiduciaries (aka senior management) had non-publicly available information available and breached duties to act on that
  - "Market unreliability" complaints that allege significant changes in market for company products or services with some kind of suggestion that market valuations were not reliable
- There are also several important post *Fifth Third* dismissals, including for CitiGroup, Delta, Lehman Brothers and UBS

DOL's Proposed Fiduciary Rule

- **<u>The Proposed Rule</u>**:
- "Fiduciary" expanded to include any individual receiving compensation for providing advice that is individualized or specifically directed to a particular plan sponsor, plan participant, or IRA owner for consideration in making a retirement investment decision will now be a fiduciary.
- Part of the purpose of the rule is to impose duties on service providers that plan fiduciaries previously had to negotiate for protection of plan and participants.
  - Not unlike DOL's foray seeking to exercise authority over auditors of pension plans.

DOL's Proposed Fiduciary Rule (cont.)

- Proposed rule creates a new PTE, the "best interest contract exemption," to allow firms to continue to set own compensation so long as provider commits (i) to putting client's best interest first and (ii) to disclose conflicts that may prevent advisor/firm/provider from doing so if provider contracts with sponsor to:
  1. Commit firm and adviser to providing advice in the client's best interest by acting with the care, skill, prudence, and diligence that a prudent person would exercise based on the current circumstances.
  2. Avoid misleading statements about fees and conflicts of interest.
  3. Warrant that the firm adopted policies and procedures designed to mitigate conflicts of interest.
  4. Specifically, the firm must warrant that it has identified material conflicts of interest and compensation structures that would encourage individual advisers to make recommendations that are not in clients' best interests and has adopted measures to mitigate any harmful impact on the client from those conflicts of interest.
  5. Clearly and prominently discloses conflicts of interest that might prevent the adviser from providing advice in the client's best interest.
  6. Direct the customer to a webpage disclosing the compensation arrangements entered into by the adviser and firm and make customers aware of their right to complete information on the fees charged.

DOL's Proposed Fiduciary Rule (cont.)

- Each of the requirements is a basis for a claim in litigation by a disgruntled investor.
- The SEC has its own duties for investment advisors.
- Congress opposition is significant; president strongly supports.
- SEC had sought joint rules to be issued, rather than DOL proceeding alone.

Some Questions for Fiduciaries That Warrant Affirmative Answers

- Do fiduciaries receive initial and ongoing training?
- Do fiduciaries understand their responsibilities, including to be familiar with the plan terms and service provider commitments?
- Are written communications to plan participants consistent with the terms of the plan? Are they consistent with each other?
- Are fiduciaries monitoring the performance and expenses of plan service providers?
- Are delegates and service providers being held responsible for compliance with their responsibilities and applicable laws and regulations?
- Are fiduciaries recording their review and decision-making?

Some Suggestions for Documenting Decisions

- Policies should
  - Provide general objectives
  - Set forth processes for review and documentation
- Agendas should
  - Summarize issues, data and alternatives considered
  - Identify processes used to obtain analysis and recommendations from staff or advisors
- Minutes should
  - Be presented in a consistent format and generally include analysis and presentations as attachments
    - Separate documentation may be appropriate for sensitive matters

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Appendix: Additional Details on

- DC plan fee litigation
- Post *Fifth Third* employer stock litigation
- Flash Survey results: capping company stock
- SPDs and Plan Documents: *Amara*
- Who is not a fiduciary – and what duties they still have
- Disclaimer on content
- Contact information for speakers

401(k) Plan Fee Litigation Update – *Spano v. Boeing Co.*, No. 3:06-cv-743 (S.D. Ill. Dec. 30, 2014) [settled]

- Facts: 401(k) ERISA excessive fee fiduciary breach suit based on evidence that the fiduciary Boeing Employee Benefit Investment Committee:
  - (1) retained the same recordkeeper (State Street/Citistreet) for more than ten years without issuance of a request for proposal (RFP), resulting in excessive fees being charged to the plan and its participants;
  - (2) chose mutual funds with higher fees rather than identical mutual funds with lower fees so as to foster the sponsor's corporate relationship with the recordkeeper/banker (State Street/Citistreet) by arranging for revenue sharing with recordkeeper/banker;
  - (3) offered participants riskier, volatile mutual funds (Dreyfuss Tech Fund) to foster Boeing's corporate relationship with a particular bank (Dreyfuss/Mellon); and,
  - (4) failed to consider (or document its consideration) as to the unitized employer stock fund whether investment drag (*i.e.*, the cash component of the fund moderating the return as compared to the return on the employer stock) and transactional drag (*i.e.*, transaction costs due to participants who trade often and generate costs that are spread among all participants) rendered unitization imprudent.
- Holding: Evidence was sufficient to defeat defendants' summary judgment motion, with bench trial set for August 24, 2015; settlement when trial was to begin.

401(k) Plan Fee Litigation Update (cont.)

- Action steps:
  - Selection of plan investments, service providers and investment managers should be made to avoid appearance that selection advances the sponsor's interests.
  - Fiduciaries must document adherence to a prudent and reasoned fiduciary process, *e.g.*, selection of unitization of employer stock fund to limit costs.
  - Regular (at least every three years) issuance of RFP is prudent.
- ***Abbott v. Lockheed Martin Corp.*, No. 3:06-00701 (S.D. Ill. Apr. 30, 2015)**
  - Court preliminarily approved settlement of fee case for $62 million, which is the highest settlement payment to date in fee cases.
  - Claims similar to *Spano*, with an additional charge that the stable value fund was misrepresented because it was really an underperforming money market fund.

401(k) Plan Fee Litigation Update – *Tussey v. ABB, Inc.*, 2015 U.S. Dist. LEXIS 89068 (W.D. Mo. July 9, 2015), *on remand*, 746 F.3d 327 (8th Cir.), *cert. denied*, 135 S. Ct. 477 (2014)

- Facts: Fidelity, recordkeeper and trustee for ABB's 401(k) plan, paid through hard fees and revenue sharing. As part of the bundling of services, revenue sharing subsidized Fidelity's corporate services to ABB unrelated to the 401(k) plan.
- Holding: ABB, which ignored consultants' warnings regarding fee cross-subsidization, under abuse of discretion standard, breached fiduciary duties by failing (i) to monitor and control recordkeeping fees and (ii) failing to make a good faith effort to prevent subsidization by the plan of corporate services to ABB.
  - Failure of proof as to damages.
- Action steps:
  - The Committee should continue to engage in a reasonable process to evaluate investment expenses, perform a prudent analysis, **document** the process, monitor ongoing fees and expenses, and separately pay for corporate services unrelated to the plans.
  - The Committee should understand **how** revenue sharing works, *i.e.*, who is paying compensation, how much is being paid, and who is receiving payment, and determine whether **total** compensation is reasonable.

401(k) Plan Fees and Litigation Update (cont.)

Kreuger v. Ameriprise Financial, Inc., No. 1:11-cv-2781 (D. Minn. Mar. 26, 2015)

- Ameriprise filed joint motion to settle fee litigation involving 401(k) plan based on allegations that plan paid excessive fees due *inter alia* to absence of a timely request for proposal ("RFP"), and utilized a proprietary fund that allegedly involved self-dealing in exchange for settlement payment of $27.5 million
  - Impending trials lead to settlements: trial had been scheduled for April 2015.
- Non-monetary settlement terms included Ameriprise conducting a RFP competitive bidding process for recordkeeping and investment consulting services.
  - The principal takeaway is that timely and regularly undertaken RFPs for all service providers, particularly recordkeepers who are involved in investment options, are necessary to address fee claims.
  - A second takeaway is that a plan sponsor and its affiliates cannot profit from a plan so that transactions with affiliates will be used as a predicate for a fee claim.
  - Third takeaway is that compliance with DOL regulations may defeat fee claims.

Golden Star, Inc. v. Mass Mutual Life Ins. Co., No. 3-11-cv-30235 (D. Mass. May 20, 2014)

- **Holding**: Mass Mutual, which was recordkeeper for 401(k) plans, designed and maintained a menu of investment options such as mutual funds, and held plan assets in separate accounts, could be treated as an ERISA fiduciary based on revenue sharing payments ("RSPs") over which it exercised discretion.
- Although "a service provider 'does not act as a fiduciary with respect to the terms in the service agreement if it does not control the named fiduciary's negotiation and approval of those terms.' *Hecker v. Deere & Co.*, 556 F.3d 575, 583 (7th Cir. 2009)," MassMutual was a fiduciary because it "had the discretion to unilaterally set fees up to a maximum and exercised that discretion."
- Under PWBA Op. 97-15A, RSPs do not violate ERISA if both disclosed to plan and structured as a dollar-for-dollar offset of plan fees or as amounts credited to the plan.
- **Action step**: The Committee should review, evaluate and document its review of 401(k) plan's "revenue sharing" arrangement with recordkeeper and periodically review thereafter.

401(k) Fiduciary Litigation Update – *Bilewicz v. FMR LLC*, 1:13-cv-10636 (D. Mass. Oct. 16, 2014)

- Facts: Complaint alleged that Fidelity engaged in "self-dealing" in having Fidelity's own 401(k) plan contract with an affiliate of Fidelity to act as the plan's investment advisor, which then selected Fidelity mutual funds as plan's investment options.
- Result: Fidelity settlement payment to class of $12,000,000 and agreement to independent fiduciary to address payments.
- Action steps:
  - Selection of plan investments, service providers and investment managers should be made to avoid even the appearance that selection advances the sponsor's interests.
  - Plan fiduciaries need to document rationale for selection of an affiliate of sponsor to provide any services to plan.
    - Fees to affiliates of sponsor of plan should never exceed documented out-of-pocket costs and are most defensible where there is no income to provider.
    - Affiliates as service providers should be vetted to ensure that the affiliate is not simply competent, but is as good as or better than alternative service providers.

Dudenhoeffer Applied: Harris v. Amgen, Inc., 770 F.3d 865 (9th Cir. 2014), *as amended* (9th Cir. May 26, 2015)

- **Holding**: Ninth Circuit reversed dismissal of ERISA breach of fiduciary duty-employer stock drop action where 401(k) summary plan description incorporated by reference SEC filings that were at heart of a Rule 10b-5 securities action in which the Supreme Court had affirmed class certification.
  - Three judges dissented from denial of rehearing *en banc* on ground that *Amgen* ignored *Dudenhoeffer*'s limitations on employer stock drop claims.
- **Legal Significance**: Securities fraud and other federal law violations may constitute a *Dudenhoeffer* "special circumstance" that can support an ERISA fiduciary breach claim.
- **Principal Takeaway**: Fiduciaries should draft plan's SPD and other fiduciary communications **not** to refer to company stock SEC filings.
  - If a fiduciary refers to a company stock SEC filing, the fiduciary should state expressly that the reference is **not** intended to be part of the SPD or any other communication made in a fiduciary capacity.

Gedek v. Perez, 2014 U.S. Dist. LEXIS 174338 (W.D.N.Y. Dec. 17, 2014)

- **Holding**: Trial court denied motion to dismiss employer stock drop action where complaint alleged that public information demonstrated fiduciary's imprudence in continuing to offer an Eastman Kodak employer stock fund in 401(k) plan in light of company's inevitable bankruptcy.
  - Not a traditional "stock drop" action because complaint alleged that Kodak's declining stock price "accurately tracked the company's steadily worsening fortunes, which had no reasonable chance of improving."
- **Legal Significance**: Bankruptcy that is obviously impending in light of public information is a *Dudenhoeffer* "special circumstance" that should inform fiduciary's actions to freeze or terminate an employer stock fund.
- **Principal Takeaways**: 401(k) plan fiduciaries should not be willfully blind as to performance of employer stock.
  - Fiduciary should regularly review company stock prices, company bond ratings, company bond prices, company news stories, and analysts' predictions relating to the company, including the exhaustion of cash or bankruptcy.
  - Fiduciary should document review and rationale for continuing to offer employer stock as a 401(k) plan investment alternative.

Dudenhoeffer followed: *Smith v. Delta Air Lines*, 2015 U.S. App. LEXIS 13165 (11th Cir. July 29, 2015) (*per curiam*)

- **Holdings**: Appellate court affirmed district court dismissal of claim.
  - After quoting *Dudenhoeffer* for proposition "that a major stock market provides the best estimate of the value of the stocks traded on it," appellate court held that claim that fiduciaries should have foreseen drop in stock price was not plausible.
  - Court held that "special circumstance [that rendered] reliance on the market price imprudent," *see Dudenhoeffer*, 135 S. Ct. at 2472, to be "fraud, improper accounting, illegal conduct or other actions that would have caused Delta stock to trade at an artificially inflated price."
    - No identification of what constitutes an "other action."
- **Principal Takeaways**:
  - Absent fraud, improper accounting, illegal conduct or other actions that would have caused artificially inflated stock price, employer stock investment is likely prudent.

Dudenhoeffer followed: *In re Lehman Bros. Sec. & ERISA Litig.*, 2015 U.S. Dist. LEXIS 90109 (S.D.N.Y. July 10, 2015)

- **Holdings**: Trial court dismissed third amended employer stock drop complaint.
  - Despite complaint allegations that public information demonstrated fiduciary's imprudence in continuing to offer Lehman employer stock fund in 401(k) plan in light of company's inevitable bankruptcy on ground that public information cannot be basis for allegation that stock is over- or under-valued, given assumption of a rational market.
  - No duty to undertake internal investigation to obtain non-public company information that would address prudence of employer stock investment.
- **Principal Takeaways**: While 401(k) plan fiduciaries should not be willfully blind as to performance of employer stock, not every drop in employer stock price due to company performance is basis for eliminating or freezing employer stock fund and mixed market messages regarding employer do not require action.
  - Court rejected *Gedek* legal analysis.

Dudenhoeffer followed: *In re Citigroup ERISA Litig.*, 2015 U.S. Dist. LEXIS 63460 (S.D.N.Y. May 13, 2015)

- **Holding**: Court relied on *Dudenhoeffer* analysis in dismissing 401(k) stock drop claim alleging that fiduciary imprudently offered employer stock where Citigroup was burdened by risky mortgages due to absence of identification of "special circumstances."
- **Legal Significance**: Court limited "special circumstances" to *Amgen*'s securities fraud/criminal misconduct and *Gedek*'s impending bankruptcy situations.
- **Principal Takeaway**: While 401(k) plan fiduciaries should not be willfully blind as to performance of employer stock, not every drop in employer stock price due to company performance is basis for eliminating or freezing employer stock fund.

Jander v. IBM, Filed May 15, 2015 in Southern District, NY

- Participants claim two counts of breach of fiduciary duty
  - Failure to prudently and loyally manage plan assets
  - Failure to adequately monitor plan fiduciaries
- Participants request the following as a result of the alleged breach
  - Class action status to cover an estimated 196,000 participants holding or buying IBM stock during 10 month “class period” in 2014 during which IBM stock decreased by almost 20%
  - Reimbursement of all plan losses and all profits participants would have made if the defendants fulfilled their fiduciary duties
  - Attorney fees
- Named defendants include company, committee and specific individuals
  - Committee included CFO and General Counsel, and both are named defendants, along with Chief Accounting Officer

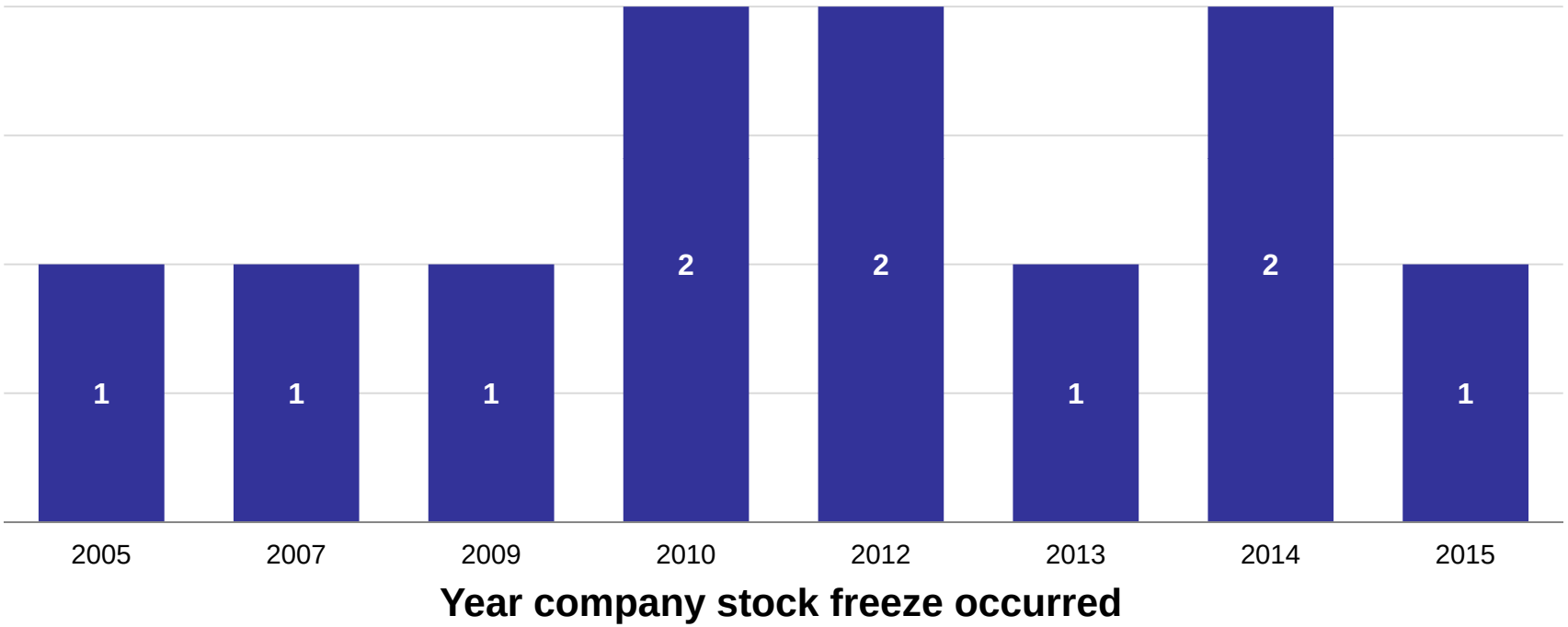
Allegations in *Jander v. IBM*

- Since the mid-2000s, IBM had stated it was restructuring its business, including through hardware sales, to support further growth
  - "Class period" for suit begins with a January 21, 2014 earnings announcement that included optimistic EPS projections
  - Attempts to sell the Microelectronics business began no later than 2013
- Plaintiffs allege that IBM misrepresented the value of the Microelectronics business to investors and buyers and finally acknowledged its losses on October 20, 2014 when they disposed of the business through an incentive payment
  - October 20th marks the end of the class period
- Plaintiffs allege that the CFO, GC and CAO participated in and had to know of the misrepresentations being made to the market
  - Plaintiffs assert no conflict with securities rules, stating that a duty of truth informs both securities and ERISA responsibilities
- Complaint is based on a mix of IBM press releases, SEC filings, analyst comments and other public information and asserts that discovery will allow identification of more specifics

Taveras v. UBS, Dismissal for Procedural Reasons

- Participants sued UBS for breach of fiduciary duties for failing to eliminate UBS company stock as an investment option at the time of the financial crisis
- District Court initially dismissed all claims but the 2nd Circuit vacated the dismissal related to one of the plans
  - Court found that the presumption of prudence did not apply to that plan as it gave the investment committee the authority to add or delete investment options including the UBS Stock Fund
- Plaintiffs' claim was subsequently dismissed again by the District Curt due to lack of standing as the plaintiffs' failed to allege facts connecting their individual loss to the plan's breach of fiduciary duty.
  - 2nd Circuit affirmed the decision citing ERISA standing qualifications that a "plan participant lacks standing to sue for ERISA violations that cause injury to a plan but not individualized injury to the plan participant."
  - The appeal of the other participants' claim, dismissed initially due to the presumption of prudence but brought back in light of the *Fifth Third* decision, was denied as the petition time for writ of certiorari expired prior to the date of the appeal.

Freeze date of company stock investments



Two of the 11 of sponsors that froze company stock as an investment option did so after the Fifth Third decision

Towers Watson 2015 Employer Stock in DC Plans Flash Survey of 160 employers, conducted in March, 2015

Who/What Is not a Fiduciary?

- Those who act in a "settlor" and/or "ministerial" capacity
  - Settlor: actions relating to plan establishment, plan design (including amending plan terms) and plan termination
    - Examples: determining whether to offer a benefit plan, type of plan, plan design, decision to close, freeze and/or terminate a plan, setting of employer contribution levels, determination of actuarial assumptions for accounting
    - In general, settlor-related expenses are not trust-payable, although DOL has provided an exception for expenses relative to legally required plan amendments

Who/What is not a Fiduciary?

- Ministerial: per DOL regulations, actions carried out by people "…who have no power to make any decisions as to plan policy, interpretations, practices or procedures, but who perform the following administrative functions …within a framework of policies, interpretations, rules, practices and procedures made by other persons …"
  - Examples: application of rules determining eligibility for participation or benefits, calculating benefits, collecting and applying contributions, preparing government reports, preparing employee communications material, making recommendations to decision-makers
  - Many outside service providers take the position that their role is ministerial
  - In general, fees and expenses related to ministerial functions are trust-payable

More on Non-Fiduciary "Settlor" Actions

- Settlor actions may also include certain plan-related financial decisions, such as
  - Determination of the amount of contribution to make to a plan in excess of ERISA or plan minimums
  - Determination of actuarial assumptions and methods for accounting treatment
- Significance of an action or decision being settlor and not fiduciary
  - Not subject to the Prudent Man Standard of Care
  - Not subject to ERISA lawsuit for fiduciary breach
  - In general, fees and expenses related to settlor actions and decisions may not be charged to the plan
  - In general, legal counsel may be privileged (generally not so for legal counsel to a fiduciary given exclusive benefit rule)

Non-Fiduciary "Settlor" Actions

- "Settlor" actions primarily relate to plan design, such as deciding to establish, amend or terminate a plan
  - Includes setting matching and/or profit-sharing contribution levels
- Implementation of a settlor act may and usually does involve fiduciary actions
  - Board decides to amend a DC plan to add automatic enrollment
  - But now this change to the plan's design must be communicated to affected employees, and communications regarding employee benefits are subject to ERISA fiduciary standards (loyalty, prudence, etc.)
  - Communication must also meet IRS compliance requirements, e.g., meet certain disclosure specifications

Disclaimer

- While we hoped you enjoyed this deck, a disclaimer is still necessary!
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