

PROTECTING YOURSELF FROM ERISA FIDUCIARY LIABILITY

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PRESENTATION AGENDA

- Introduction
- Fiduciary Rules
- Fiduciary Liability
- Prohibited Transactions
- Best Practices
- Hot Topics

ERISA – WHAT IS IT? THE BASICS

- Comprehensive federal law
 - Employee Retirement Income Security Act of 1974
- Regulates employee benefit plans
 - Protects participants and beneficiaries
 - Requires disclosure and reporting
 - Establishes “standards of conduct, responsibility, and obligation for fiduciaries”
 - Provides for “appropriate remedies, sanctions, and ready access to the Federal courts.” ERISA § 2(b).

ERISA, FIDUCIARY ISSUES, & TAX

- ERISA is deeply interconnected with the Internal Revenue Code
- Tax qualification
 - Plan disqualification
- Tax penalties
- Enforcement / audits (IRS & DOL)

WHAT ERISA/PLAN ROLE(S) DO YOU PLAY?

- Participant
- Business
 - Compliance
 - Strategy
 - Design
 - Operation
- Fiduciary

WHO IS A FIDUCIARY? YOU?

- Plan sponsor (the company)
- Plan administrator (often a committee)
- Individuals
 - By designation (personal/title)
 - Service on a committee
 - Functional - i.e., you are a fiduciary to the extent you exercise discretion or control with respect to the plan

WHAT IT MEANS TO BE A FIDUCIARY

- Fiduciaries must affirmatively do certain things

....and

- Fiduciaries must avoid other things



WHAT FIDUCIARY RULES DO YOU HAVE TO FOLLOW?

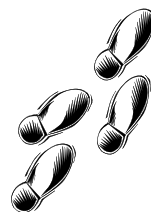
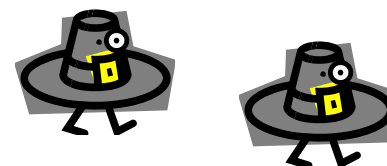
- Internal Revenue Code
 - Tax qualification rules for qualified plans (e.g., 401(k))
 - Exclusive benefit
 - Plan document requirement
- ERISA
 - Fiduciary rules set forth affirmative duties
 - Avoid prohibited transactions and fiduciary breaches
- Plan terms and rules

ERISA'S BASIC FIDUCIARY RULES

- Fiduciary “Do’s”
 - Exclusive Benefit/Purpose Rule (duty of loyalty)
 - Prudence Rule (duty of care)
 - Diversification/Investment Rule
 - Plan Documents Rule
- Settler vs. fiduciary functions
- Co-fiduciary liability
- Fiduciary “Don’ts”
 - Prohibited transactions
 - Self dealing

EXCLUSIVE BENEFIT RULE

- Duty to act solely for benefit of participants and beneficiaries
- Fiduciaries typically wear two hats: the fiduciary role and the business role
- Conflicts of interest: question of degree
 - May need to step aside



BUSINESS FUNCTION EXCEPTION

- Business functions are not subject to fiduciary rules
 - Starting a plan
 - Terminating a plan
 - Plan design and modification
- Following the plan and implementing business decisions are fiduciary functions
- Distinguishing business and fiduciary functions can be tricky

PRUDENCE RULE

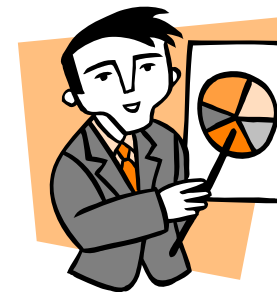
- Must discharge duties with the care, skill, prudence and diligence of a similarly situated prudent person
- Good outcome is not enough
- Absence is not a good defense

PRUDENCE RULE (CONT.)

- Largely a procedural rule
 - Was the fiduciaries' consideration adequate under the circumstances?
 - Was their investigation thorough enough?
 - Did they consider the appropriate factors?
 - Did they consult experts where appropriate?
 - Did they weigh/debate alternatives?
- Documentation

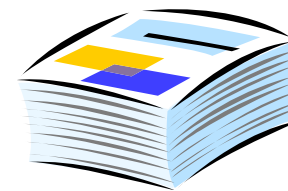
DIVERSIFICATION RULE

- Plan Administrator is generally responsible for all investment decisions regarding plan assets
- 401(k) plans – ERISA § 404(c) has a limited exception
 - Mandates certain amount of diversification in investment options
 - Procedural and disclosure requirements
 - Ongoing duty to monitor
 - Investment education vs. advice
- Employer stock – special rules



PLAN DOCUMENTS RULE

- Fiduciaries must follow the plan documents unless they conflict with ERISA
 - Example: lawsuits regarding company stock funds in 401(k) plans
- Plan documents: Plan, trust, summary plan description (SPD), etc.



OTHER DUTIES OF THE PLAN ADMINISTRATOR

- Selection and oversight of plan service providers
 - E.g., recordkeeper, trustee, investment advisors, legal counsel, auditor, Form 5500 preparer, and others
- Selection and monitoring of investments
- Annual reporting
 - Form 5500
 - Summary Annual Reports for DC plans
 - Funding Notices and PBGC filings for DB plans

OTHER DUTIES OF THE PLAN ADMINISTRATOR (CONT.)

- Ensuring tax and legal compliance
- Maintenance and upkeep of plan documents and records
 - SPDs and Summaries of Material Modification
 - IRS determination letter filings
- Handling participant claims and appeals

FIDUCIARY LIABILITY

- Liability is personal



- Indemnification by plan sponsor
 - May be offered through plan
 - May be offered directly by plan sponsor
 - Usually an exception for gross misconduct
- Insurance protection

LIABILITY FOR OTHER FIDUCIARIES

- Co-fiduciary liability for the breach of another fiduciary exists if—
 - A fiduciary knowingly participates in or acts to conceal another fiduciary's breach
 - By failing to comply with the fiduciary standards, a fiduciary enables another fiduciary to commit a breach
 - The fiduciary has knowledge of a breach by another fiduciary and does not act to correct it (which might require going to court)
- Duty to monitor delegations/appointments



PROHIBITED TRANSACTIONS (FIDUCIARY “DON'TS”)

- Transactions between a plan and a “party in interest” are generally prohibited
 - Loans or extensions of credit
 - Sales, exchanges, or leases
 - Transfers of property
 - Furnishing of goods or services

- Fiduciary self dealing prohibited



PROHIBITED TRANSACTIONS (CONT.)

- Parties in Interest
 - Fiduciaries
 - Service providers
 - Company, and its affiliates
 - Company employees, officers, directors and 10% shareholders
 - Participants other than in their capacity as participants

PROHIBITED TRANSACTIONS (CONT.)

- Some exceptions to PT Rules
 - Employer securities
 - Loans to participants
 - Fiduciary participation in a plan
 - Reasonable compensation for services
- Exceptions come in different forms
 - Statutory/regulatory exceptions
 - DOL class and private exceptions

PROHIBITED TRANSACTIONS (CONT.)

- Prohibited transactions are reported on IRS Form 5500 for the plan
- Prohibited transactions trigger an excise tax under Internal Revenue Code section 4975

PROHIBITED TRANSACTIONS (CONT.)

- **Examples of Possible Violations**
 - Discounts for the company from plan vendors
 - Hiring a company affiliate as a service provider
 - Use of plan assets to pay company expenses
 - Gifts and commissions from vendors
 - Failure to comply with participant loan rules
 - Noncash contributions to DB plans

- This is an area where asking questions when you're not sure is a good idea

BEST PRACTICES – WHAT TO DO?

- Prudent Process – maintain and document
 - Have a three-person Committee (at least)
 - Meet on a regular basis and document the decision-making process
 - Consider establishing an investment policy
 - Choose vendors by getting bids and evaluating services/fees
 - Evaluate vendors on a regular basis
 - Ensure that plan provisions and procedures are properly followed



BEST PRACTICES – WHAT TO DO? (CONT.)

- Focus on fees paid from the plan and 401(k) investment fees
- Compliance with disclosure regulations:
 - 404(c) information to 401(k) plan participants
 - 408(b)(2) service provider information to fiduciaries: Initial disclosures in 2012 and any updates
 - Annual fee disclosure to 401(k) plan participants
 - Annual QDIA notice



CURRENT FIDUCIARY HOT TOPICS – 401(K) PLANS

- 401(k) plan fees
 - Widespread lawsuits and big-dollar settlements
 - Ongoing DOL initiatives
- Target retirement date funds
- Company stock funds

CURRENT FIDUCIARY HOT TOPICS – PENSION PLANS

“De-risking” strategies, including:

- Liability-driven investment strategies
- Lump sum windows
- Plan termination



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