Avoiding Mistakes in Running Retirement Plans

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Presenters

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- **Tom Shaevsky** is a shareholder based in Butzel Long's Bloomfield Hills office. He is a graduate of the University of Michigan Law School (J.D., 1992, *magna cum laude*, The Order of the Coif; Michigan Law Review: Contributing Editor), and the University of Michigan (B.A., with high distinction, Angell Scholar, 1989). He has been named The Best Lawyers in America ERISA "Lawyer of the Year" in 2014, selected by his peers for inclusion in The Best Lawyers in America (Employee Benefits Law), a Leading Lawyer, and named an Employee Benefits Law Top Lawyer by DBusiness Magazine. He advises multinational corporations, physicians and other professional practices, hospitals, and other nonprofit employers, on compliance and planning issues pertaining to a wide range of retirement and welfare plan issues.

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Overview

- Over the years we've seen countless well-meaning Retirement Plan Sponsors and Plan Administrators make potentially costly mistakes
- Most had no idea that what there was an option to do things better than the way they were handling them
- Others knowingly cut corners "to save money"

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Overview

- Today we will cover only a portion of the BAD and the UGLY:
  - Bad terms in **TPA or Recordkeeping Service Agreements**
  - Bad or missing **Investment Advisory Agreements**
  - Bad commitments in **Investment Policy Statements**
  - Bad **Plan language** on fiduciary duty
  - Bad terms in **Trust Agreements**

(Cont.)

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Overview

(Cont.)

- Bad (or no) fiduciary **Charters**
- Bad **recordkeeping**, especially in regard to participant loans and hardship distributions
- No attention to **participant-paid fees** or **fee allocations**
- No attention to **vendor fee levels**

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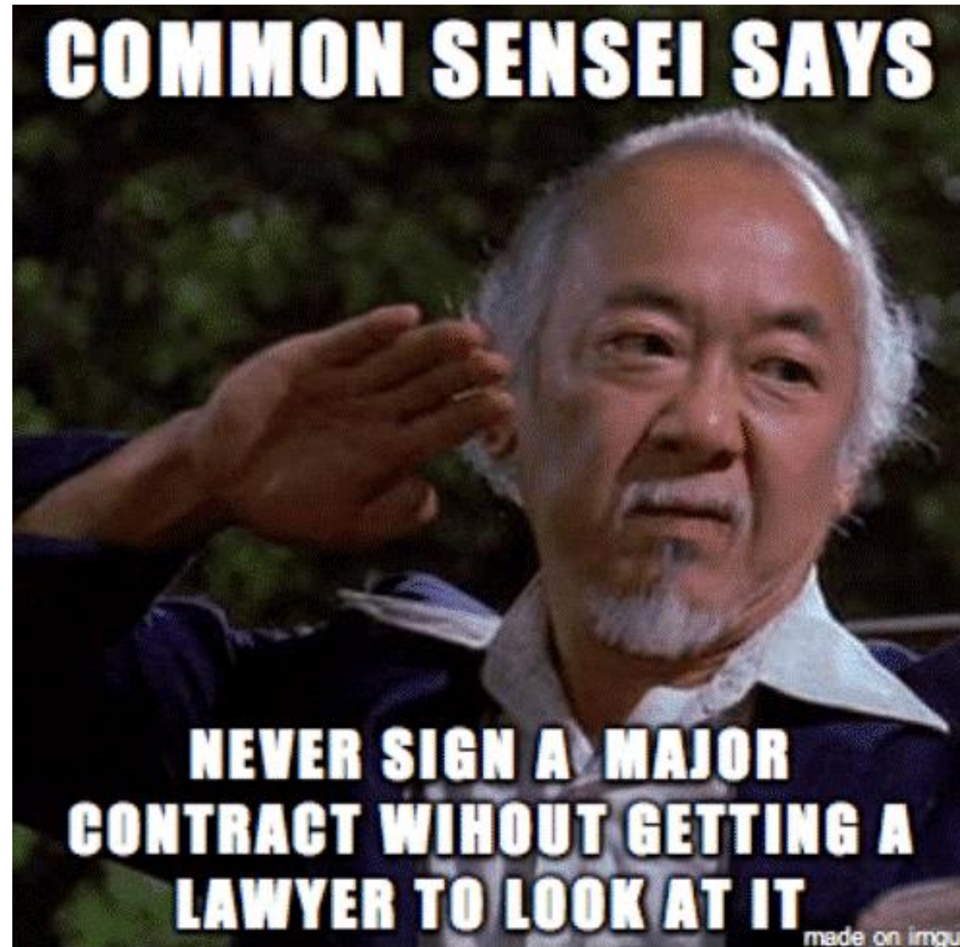
TPA and Recordkeeping Agreements



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TPA and Recordkeeping Agreements

Background:

- Employers tend to assume that they're stuck with the terms of the Third-Party Administrator or Recordkeeping Agreements they're given
- All of these contracts are skewed in favor of the company that prepared them

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TPA and Recordkeeping Agreements

Traps for the Unwary:

- Limitations on liability for vendor's errors
  - Most agreements require the Employer to read every record the vendor creates, and if no complaint is filed within a brief window of time, the vendor's liability for correcting their error is waived
    - Even if the error was not evident without additional information
    - Even if the vendor was grossly negligent in causing the error

This limitation on liability should be renegotiated to apply only to the vendor's obligation to create a corrected report

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TPA and Recordkeeping Agreements

Traps for the Unwary:

- Indemnification/hold harmless obligations
  - Most agreements contain unequal indemnification/hold harmless provisions
    - The circumstances under which the Employer must pay when its error caused a problem are more expansive than the circumstances under which the vendor must pay when its error caused a problem
    - The vendor contract seldom agrees to indemnify the Employer-side parties when the vendor breaches the contract or violates the law
    - Employer's fiduciary liability insurance likely won't cover Employer's obligation to indemnify

Indemnification provisions should be renegotiated to be reciprocal and comprehensive

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TPA and Recordkeeping Agreements

Traps for the Unwary:

- Ownership of records
  - Most agreements fail to state that the records the vendor receives and creates while providing services are assets of the Plan
    - A vendor's use or misuse of Plan assets makes the vendor a functional fiduciary under ERISA, with fiduciary liability
    - When records are Plan assets, vendors cannot use for their personal marketing purposes/sister company solicitations, and records must be turned over upon request and upon termination of the contract
    - Courts disagree over whether Plan records are Plan assets, but recent DOL cybersecurity guidance states fiduciaries have a duty to ensure vendors protect them

Agreements should commit to maintain the industry standard of protection for plan records, including electronic records

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TPA and Recordkeeping Agreements

Traps for the Unwary:

- Arbitration provisions overly broad
  - Most agreements require all disputes to be submitted to arbitration
    - But under ERISA, the Plan fiduciaries can be sued in federal court by participants, other fiduciaries, or the Department of Labor
    - That means a single issue may be subject to litigation at the same time its subject to arbitration, increasing costs and creating the possibility of conflicting outcomes

Agreements should negotiate to make arbitration voluntary only, so it can be prudently used or rejected, as circumstances dictate

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TPA and Recordkeeping Agreements

Traps for the Unwary:

- Jurisdiction, venue, and choice of law provisions favor the vendor
  - Most agreements give the vendor either the home field advantage or the ability to require a court to apply the law of a state that has laws or legal decisions that are to their advantage
  - The statute of limitations on filing a lawsuit for breach of contract varies widely from state to state, and ERISA turns to state law for this purpose

Don't agree to jurisdiction, venue, or choice of law provisions without understanding what you're giving up

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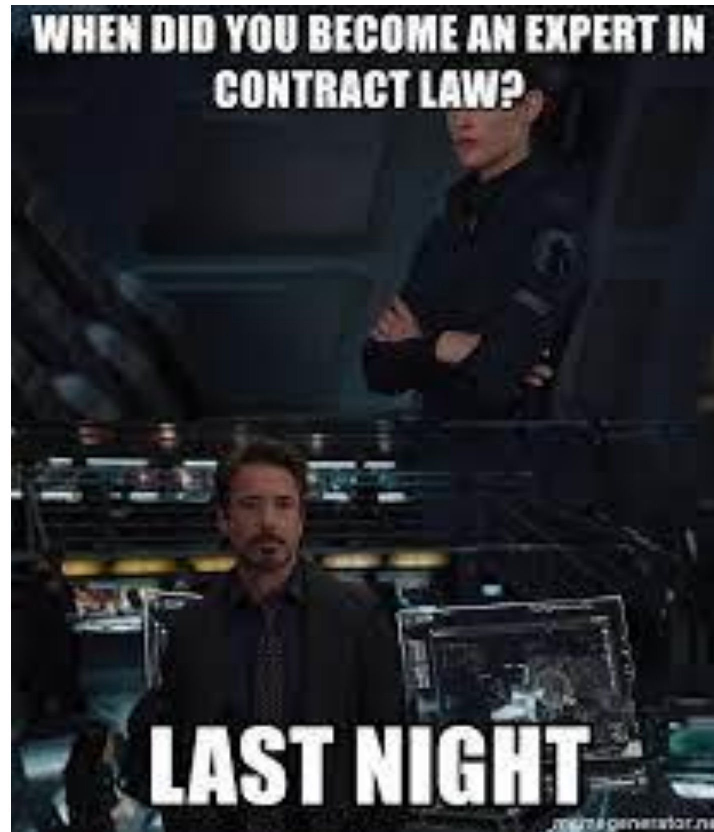
Investment Advisory Agreements



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Investment Advisory Agreements

Background:

- Plan fiduciaries may (and probably should) retain an Investment Advisor to provide Plan fiduciaries with professional investment advice or to manage the Plan's assets
- When a Plan fiduciary prudently retains and monitors a professional Investment Advisor, the fiduciary is largely insulated from liability for the Plan's investment losses

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Investment Advisory Agreements

Background:

- Bad Investment Advisory Agreements can fail to protect the Plan fiduciaries as intended, or worse, can actually create liability for Plan fiduciaries
- In addition to the same issues noted in bad TPA/Recordkeeping Agreements, bad Investment Advisory Agreements can contain the following problems

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Investment Advisory Agreements

Traps for the Unwary:

- Plan fiduciaries have a duty to prudently select a Plan Investment Advisor
  - Retaining someone because they're the only investment advisor you know is not prudent
  - Retaining someone who lacks experience with ERISA-governed plans is not prudent

Solicit proposals from multiple qualified investment advisors and interview each before deciding

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Investment Advisory Agreements

Traps for the Unwary:

- Investment Advisors to the Plan are fiduciaries, and must acknowledge that in writing
  – Investment industry professionals without qualified plan experience may not be aware of ERISA's requirements

The investment advisory process for a Plan is much different than for individuals – you can't just hire someone you know

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Investment Advisory Agreements

Traps for the Unwary:

- The Investment Advisory Agreement should require the Advisor to provide (or select) appropriate benchmarks for each investment, and to report on performance versus these benchmarks and versus peer retirement plans, including benchmarks for investments falling within blended investment categories

Underperformance considering the level of risk of an investment can be masked through the use of inappropriate benchmarks

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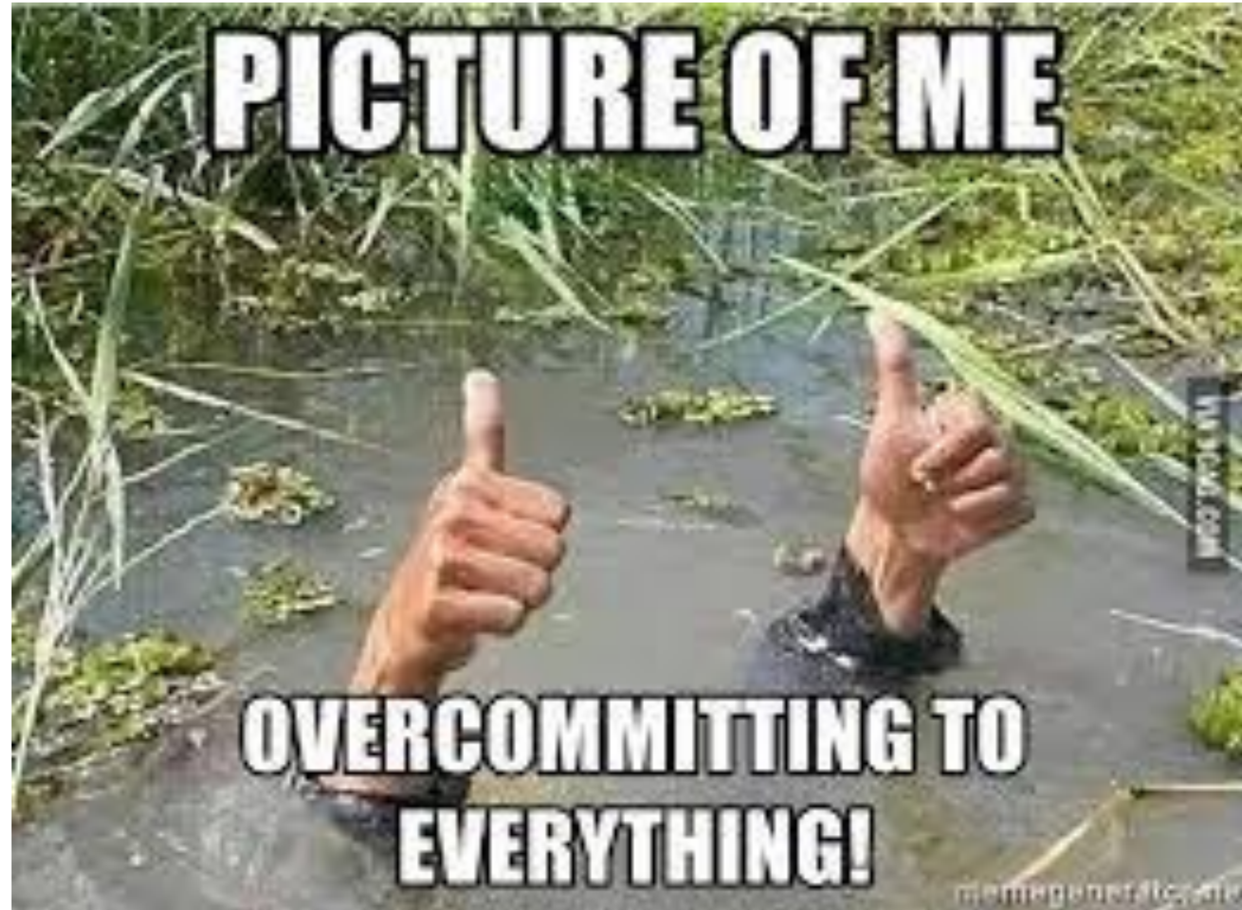
Investment Policy Statements



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Investment Policy Statements

Background:

- Investment Advisors typically propose an Investment Policy Statement ("IPS") for the Plan Administrator to adopt:
  - detailing the respective roles and responsibilities of the Plan Administrator versus those of the Investment Advisor
  - detailing aspects of the processes the Investment Advisor will use to selector recommend investments, and monitor investments

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Investment Policy Statements

Traps for the Unwary:

- The IPS should not require the Plan Administrator to rigorously follow a specific set of procedures in reviewing investment performance or the Investment Advisor's performance -- room for reasonable exceptions should be built in

If the IPS mandates a process and the Plan Administrator does not follow that process to the letter, regardless of the reason, the Plan administrator can be held liable for its failure to follow the rules it adopted

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Investment Policy Statements

Traps for the Unwary:

- The IPS should not require the use of the Investment Advisor's proprietary investment review or ranking system

The Plan Administrator is not an investment expert and lacks the ability to determine whether the Investment Advisor's process is reasonable, prudent, and meets industry standards

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Investment Advisory Agreements

Traps for the Unwary:

- In any Plan, and especially in participant-directed individual account Plans, investment fees are the subject of much litigation
- Both "no-fee funds" as well as "revenue-sharing funds" should be considered -- in some cases, revenue-sharing funds may be less expensive net of the revenue returned to the Plan

The Investment Advisory Agreement should obligate the advisor to consider investment fees in making fund recommendations

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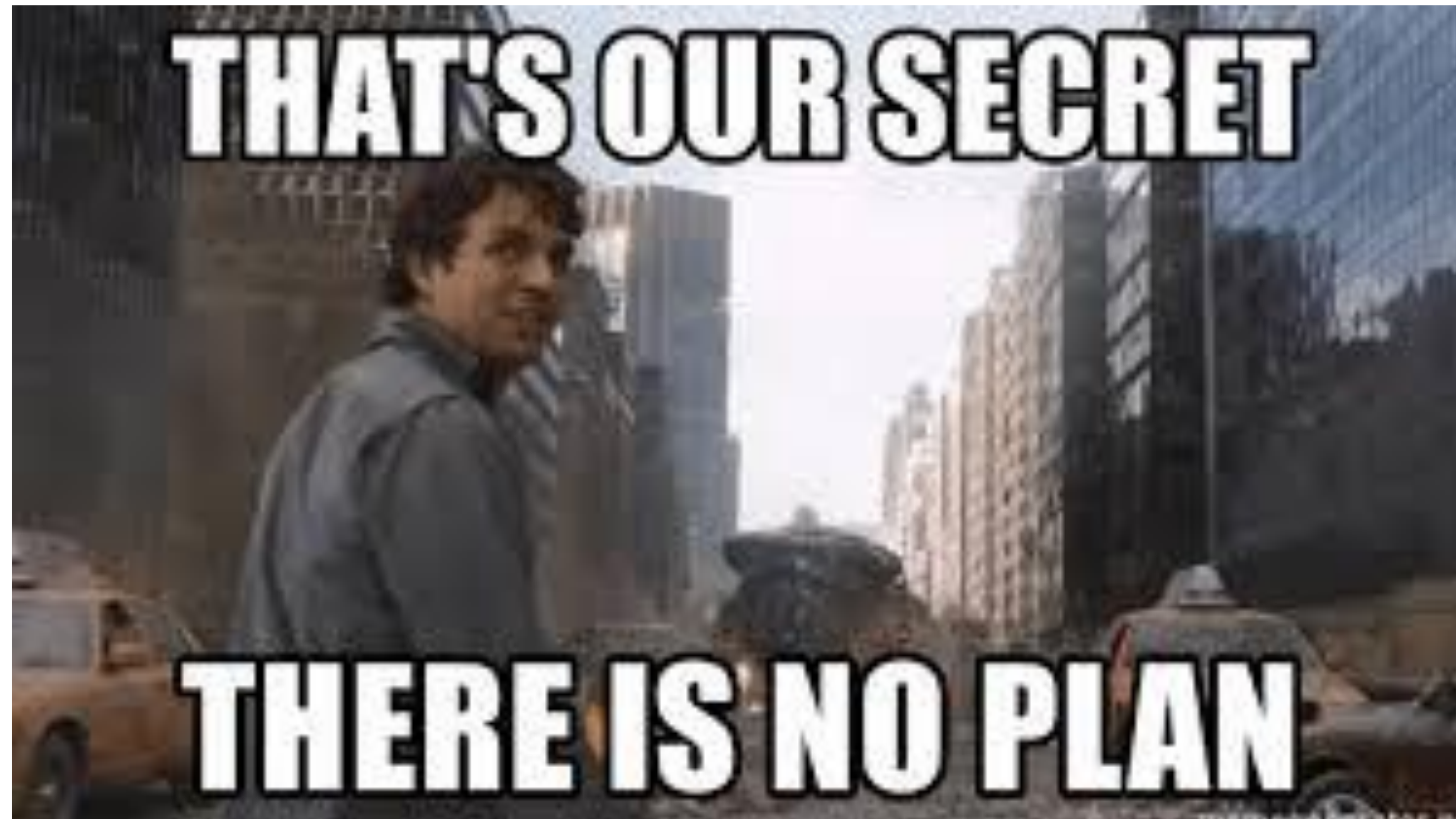
Plan Language



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Plan Language

Background:

- Under ERISA, the Plan Administrator is required to administer the Plan *in accordance with its terms*, and can be held personally liable for a breach of fiduciary duties upon failing to do so

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Plan Language

Traps for the Unwary:

- A Plan Document should not mandate that actions will occur at specified dates without consideration for whether that is administratively feasible
- For example:
  - "Payments to a vested deferred participant will begin at Normal Retirement Age" -- but the individual hasn't submitted a benefit application, or hasn't submitted a spousal waiver, or is missing
  - "Your participation in the Plan's Elective Deferrals will begin on the first Entry Date following the date you become an Eligible Employee" – but the employee hasn't submitted a Salary Deferral Election form, or isn't still employed on that date, or has insufficient pay to make the elected Salary Deferral

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Plan Language

Traps for the Unwary:

- The Plan Document contains provisions the Plan Administrator doesn't understand, and therefore doesn't properly implement
- For example:
  - "Compensation means the Participant's wages as defined in Code §3401(a) and all other compensation by the Employer for which the Employer is required to furnish a written statement under Code §§6041(d), 6051(a)(3) and 6052, as well as amounts that would have been received and includible in taxable compensation but for an election under Code §125(a), Code §132(f)(4), Code §402(e)(3), Code §402(h)(1)(B), Code §402(k), or Code §457(b)" ***-- but the payroll system is not set up to trigger elective deferrals calculated based on this definition***
  - "Profit Sharing contributions shall be 2% of eligible Compensation for the computation period" ***-- but the computation period selected is the calendar year despite the fact that Profit Sharing contributions are remitted to the Plan on a per payroll basis, meaning an annual true-up may be (unintentionally) required***

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Plan Language

Traps for the Unwary:

- The Plan Document fails to grant the Claims Reviewer (usually the Plan Administrator) complete final discretionary authority to make claim determinations and fails to state the limitation period for filing suit after a claim is denied, and/or the Summary Plan Description fails to put participants on notice of this discretionary authority and the cut-off period for filing lawsuits

Courts grant special deference to a fiduciary delegated complete discretion to make decisions regarding claims, and fact-disputes are limited to the record the fiduciary had before it at the time

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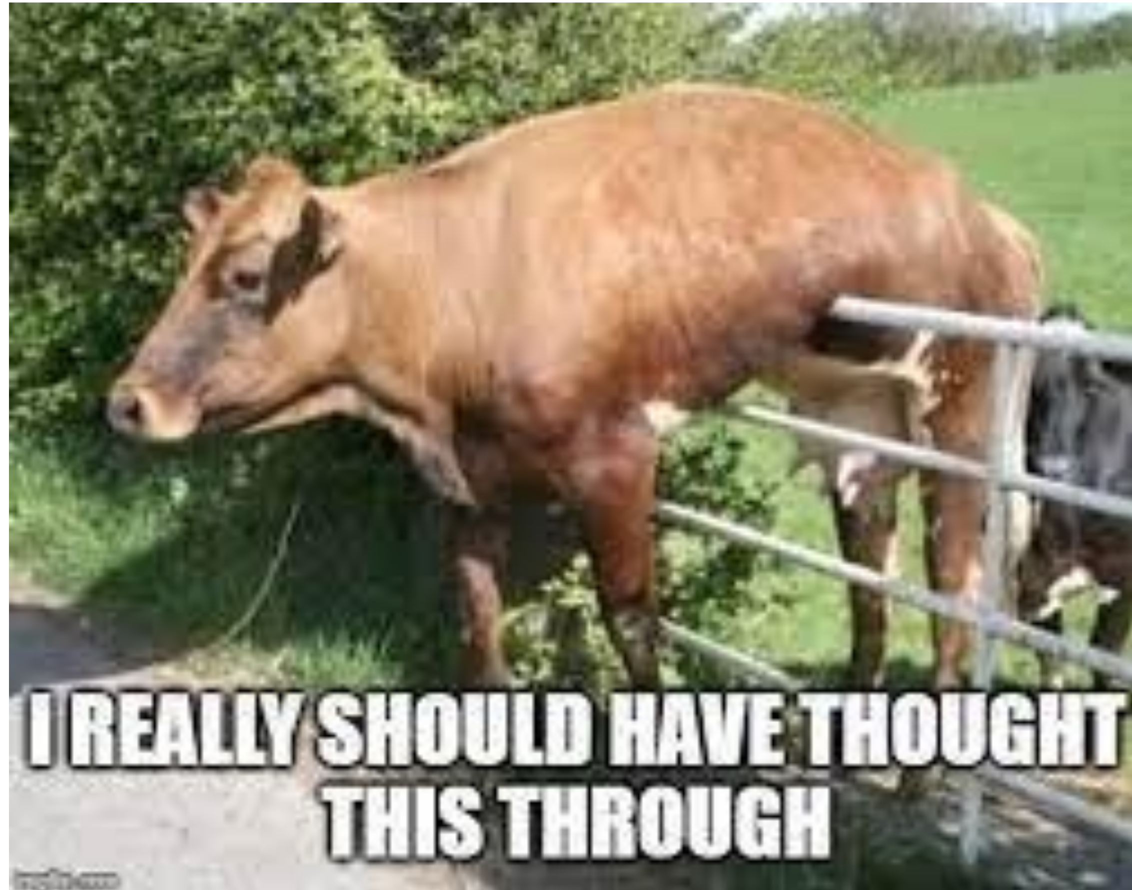
Trust Language



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Trust Language

Background:

- A Trust document is required under the Tax Code and under ERISA for a qualified retirement plan
- The Trust Agreement specifies the rights and responsibilities of the Trustee(s)
- In some cases, a Custodial Agreement is used

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Trust Language

Traps for the Unwary:

- Trust Agreements prepared by commerical entities serving as Trustee disavow responsibility for ensuring that contributions are properly remitted to the Trust
- The DOL position is that someone must be responsible for monitoring and enforcing the employer's contribution obligations

A designated/limited Trustee should also be appointed with responsibility for monitoring contributions for timeliness and pursuing delinquent contributions

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Trust Language

Traps for the Unwary:

- Many Trust Agreements contain a commitment by the Plan Sponsor to make timely contributions to the Trust, but many don't understand the timing constraints or monitor contributions

If this language cannot be removed from the Trust, a system of checks and balances, together with mandated reporting, should be implemented to track compliance

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Trust Language

Traps for the Unwary:

- As with other service-provider agreements, Trust Agreements are drafted to favor the Trustee
  - Time-limits on approving accountings
  - Unilateral indemnification in favor of the Trustee
  - Lack of provisions on data privacy and cybersecurity
  - Lack of insurance for fiduciary liability, errors and omissions, data breaches
  - "Home court" jurisdiction and venue provisions
  - Overly-broad arbitration provisions
  - Overly-broad limitations on obligations in custodial agreements (Custodians like to say they are not fiduciaries whatsoever -- the Department of Labor disagrees)

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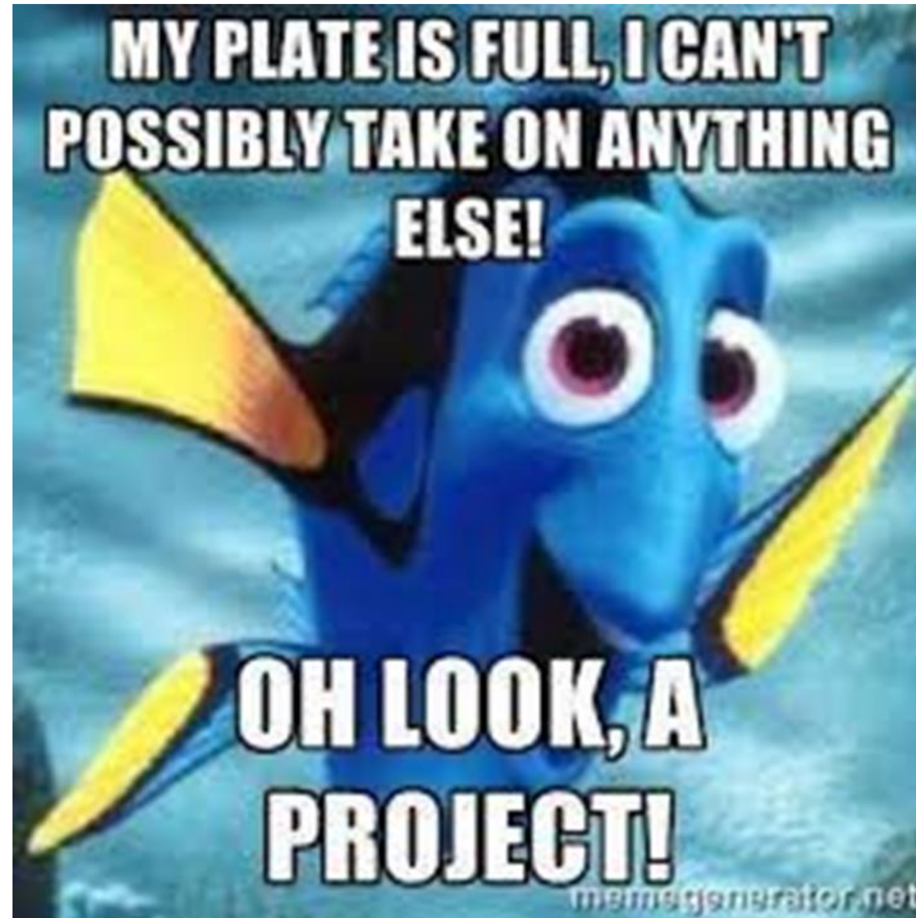
Fiduciary Charters



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Fiduciary Charters

Background:

- Under ERISA, the Plan Sponsor is the "named fiduciary" for a qualified retirement plan unless another named fiduciary is designated
- A committee can serve as the named fiduciary, to segregate the plan sponsor's non-fiduciary "settlor" actions from those actions that are fiduciary in nature
- Fiduciaries must act in the exclusive best interests of plan participants and beneficiaries
- A Charter details the scope of authority and responsibilities delegated to the committee

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Fiduciary Charters

Traps for the Unwary:

- If a committee undertakes duties that are fiduciary in nature, but no Charter exists:
  - there's no way to demonstrate that the committee is within the scope of its delegated powers and responsibilities

Participants can argue that the Plan Administrator failed to follow the terms of the Plan, and the decision is invalid.

Insurer can argue that the fiduciary insurance does not cover damages or litigation arising from unauthorized acts.

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Fiduciary Charters

Traps for the Unwary:

- If a committee undertakes duties that are fiduciary in nature, but no Charter exists:
  - there is no system of governance in place that will help ensure prudent, nondiscriminatory plan administration

For example: If the full committee is not present, but a majority of those present votes in favor of an action, is that sufficient? What if that's a minority of the members? What if it's one person?

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Fiduciary Charters

Traps for the Unwary:

Unless there is a fiduciary committee Charter and protective Plan language in place --

- Individual employees (usually HR personnel) that handle Plan matters may face personal liability as Plan fiduciaries
- Additionally, the Charter and Plan may state that the Employer itself (i.e., the corporation, LLC, etc.) is the fiduciary, and provide that employees operate solely on behalf of the Employer (which can only act through its employees); Case law is mixed on whether this will be effective in shielding individuals from liability

Protective Plan language, and a well-drafted Committee Charter, may protect in-house HR personnel from individual liability

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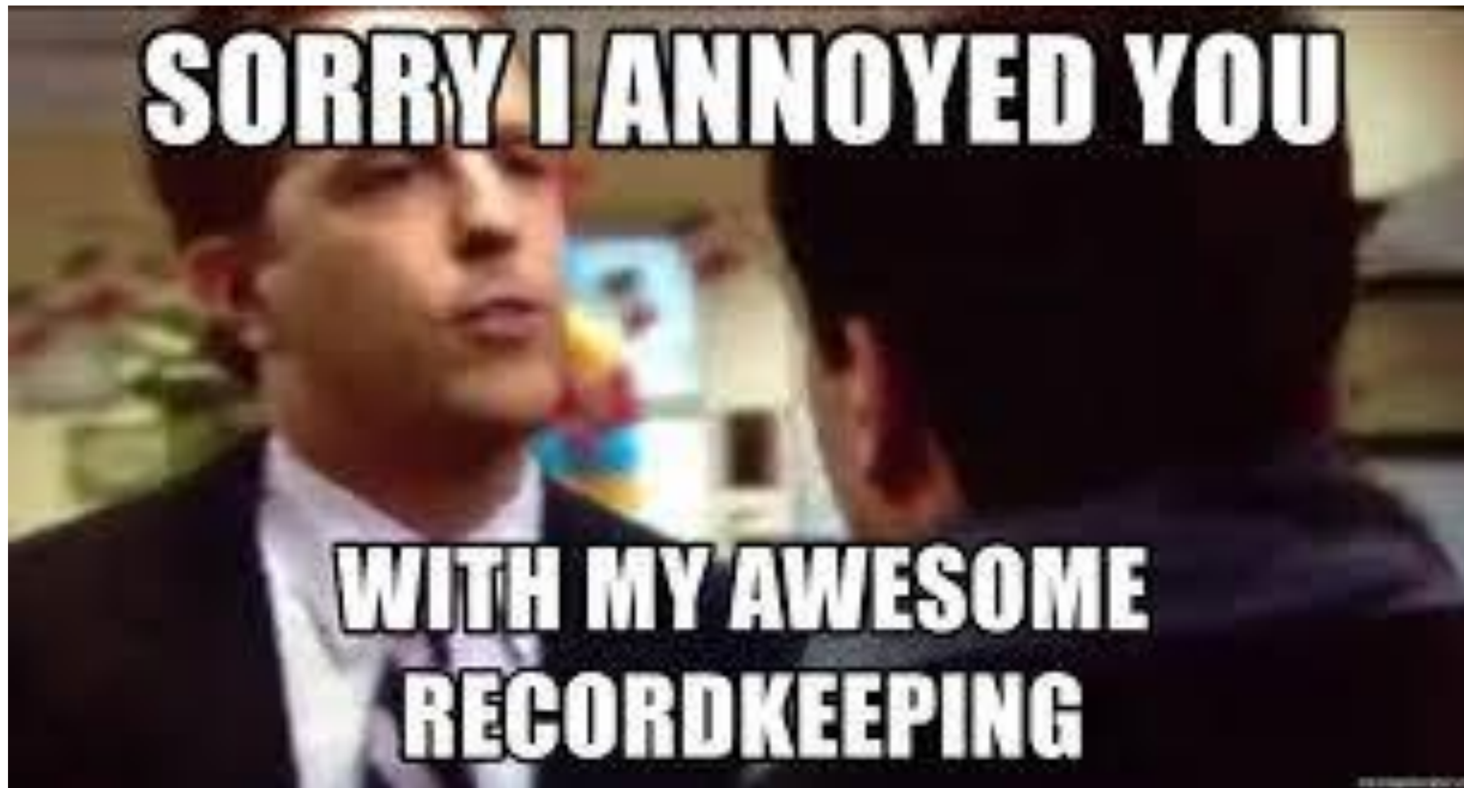
Recordkeeping



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Recordkeeping

Background:

- ERISA requires plan fiduciaries to follow prudent processes
- Sound recordkeeping helps ensure that the fiduciaries can demonstrate that they followed a prudent and consistent process in each instance
- Sound recordkeeping helps avoid costly mistakes

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Recordkeeping

Traps for the Unwary:

- Minutes reflecting the fact that the plan fiduciaries followed a prudent process to make a decision are key to avoiding liability

Minutes that purport to quote what was said word-for-word during discussion at a meeting can backfire, by creating an impression that the quoted language was the sole discussion, and that no other discussions took place

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Recordkeeping

Traps for the Unwary:

- Policies and procedures help document the reasonable, consistent, and prudent processes to be followed in administering a plan in a nondiscriminatory manner

Some outside Recordkeepers provide an Administrative Guide to plan administration that specifies the steps to be taken in various situations, and contractually require it to be followed, but the plan administrator fails to read, understand, or follow those guides, or the Administrative Guide itself creates problems

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Recordkeeping

Traps for the Unwary:

- It is crucial to accurately track hire dates, entry dates, leave dates, termination dates, rehire dates, dates of status changes, and (for most plans) hours worked

If poor recordkeeping of Plan data causes a plan administrator to improperly exclude an employee from participating in the plan for a period of time, the Plan Sponsor generally must correct the operational failure at its own cost

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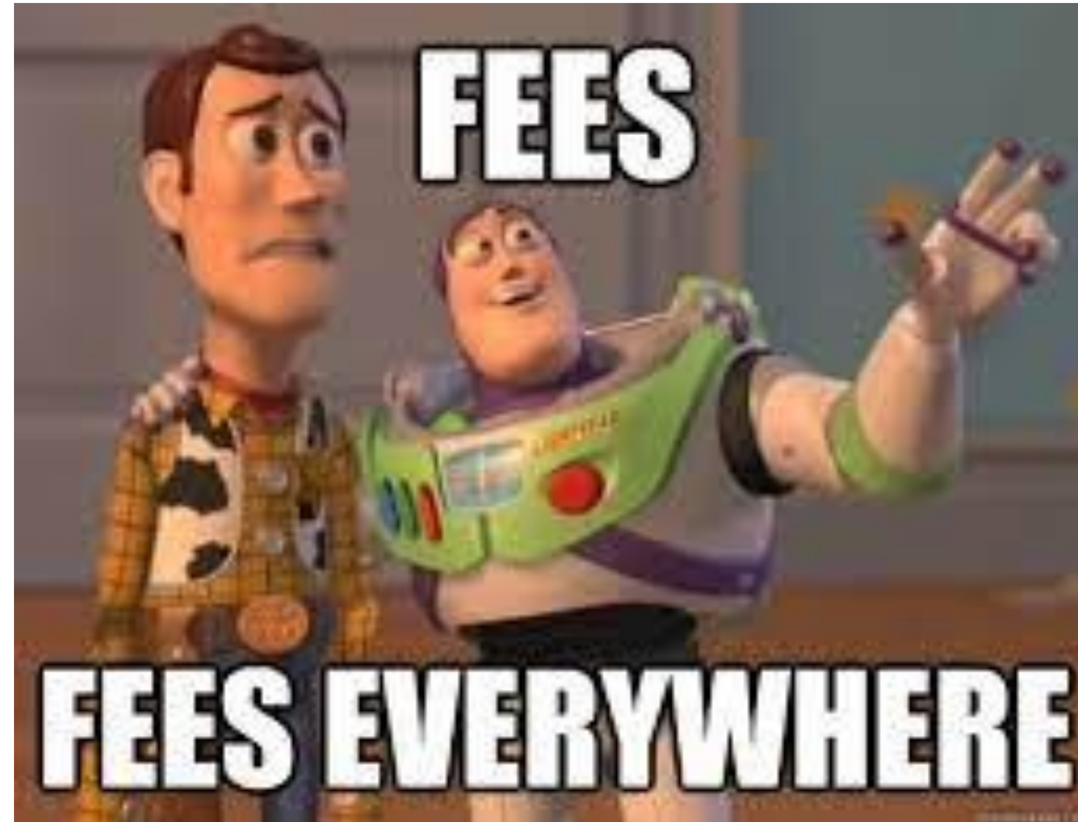
Participant-Paid Fees



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Fees

Background:

- Many retirement plans pay service-provider fees from plan assets, through direct charges or through 12b-1 fees that reduce the net investment income
- Many plan participants are not aware of these fees being paid
- Fees paid to plan service providers must be reasonable under the circumstances
- A rash of lawsuits in recent years have alleged the 12b-1 fees charged in defined contribution plans are too high because plan fiduciaries failed to prudently select and monitor plan investments

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Fees

Traps for the Unwary:

- Plan asset levels increase over time, but plan fiduciaries fail to respond accordingly
  - Plan recordkeeping fees must be reasonable under the circumstances, but when a recordkeeper is paid through 12b-1 fees fiduciaries must monitor to determine whether the aggregate fees paid continues to be reasonable
  - When the level of money invested in an investment fund grows to the point that a less expensive share class is available, a change in share classes should be made, if appropriate

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Fees

Traps for the Unwary:

- Some investment funds pay more in 12b-1 fees than others, and as a result, one participant may pay more toward the cost of plan recordkeeping than another participant with a similar account balance
- Plan fiduciaries may consider fee levelization, to reduce the impact of discrepancies in fees paid
- One simple (and transparent) approach is to return to each participant whatever revenue-sharing her Plan investments have generated, and then charge all participant accounts directly for the Plan expenses passed through to participants

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Fees

Traps for the Unwary:

- Revenue sharing may be retained at the Plan level to pay expenses or may be returned to Plan participants
- Some investment funds pay no revenue sharing but may charge lower gross expenses than the same fund in a class that would pay revenue sharing
- The true cost of investment funds should be determined <u>net</u> of revenue sharing returned to the Plan

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Questions?

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