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Who's Minding the Baby? ERISA Plan Governance Considerations

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Operating an employee benefit plan is anything but simple. Benefit plan fiduciaries face personal liability if they breach their fiduciary duties, and the last decade has seen a surge in Employee Retirement Income Security Act (ERISA)-related litigation. Employers should consider the overall design of their benefit plan governance and operational structures with care, and be thoughtful about the individuals and vendors chosen to operate and oversee those plans.

Section 402 of ERISA provides that, "Every employee benefit plan shall be established and maintained pursuant to a written instrument. Such written instrument shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan."

As any person (un)fortunate enough to serve as an ERISA named fiduciary will quickly discover, operating and administering a benefit plan is much easier said than done. As the Supreme Court observed, "An employer that makes a commitment systematically to pay certain benefits undertakes a host of obligations, such as determining the eligibility of claimants, calculating benefit levels, making disbursements, monitoring the availability of funds for benefit payments, and keeping

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appropriate records in order to comply with applicable reporting requirements."[1]

Section 404 of ERISA requires that a fiduciary discharge his, her, or its duties "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." Since Sections 409 and 502(a)(2) of ERISA impose personal liability on fiduciaries who breach this duty of care, the stakes are high when an employer selects its benefit plan fiduciaries and administrative staff.[2] Furthermore, even leaving aside the overarching legal risks associated with poorly operated benefit plans, many employers spend a lot of time and money on their benefit plans with the specific goal of recruiting and retaining quality employees. If the people responsible for operating the plans do a bad job, the employer is much less likely to accomplish these goals.

Accordingly, an employer should consider its options carefully when designing its fiduciary governance structure. Individual fiduciaries, in turn, should understand their legal obligations and make thoughtful decisions when selecting administrative staff and outside vendors.

THE NAMED FIDUCIARY

A "named fiduciary" is "a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary (A) by a person who is an employer or employee organization with respect to the plan or (B) by such an employer and such an employee organization acting jointly."[3] Historically, it has been common for the plan document to identify the sponsoring employer as the "named fiduciary."[4] Most "off the shelf" plan documents are still written this way, but this is often not the best practice.

The Employer as Named Fiduciary

When a plan identifies a company as the named fiduciary, that company needs to carry out its fiduciary duties through individual human beings. ERISA does not limit fiduciary responsibilities (and associated liabilities) to "named fiduciaries." Instead, Section 3(21) of ERISA imposes "fiduciary" status on anyone with discretionary authority or control over the administration of the plan, anyone with control over the management or disposition of plan assets, and anyone who renders (or is obligated to render) investment advice for a fee with respect to the plan's assets. Furthermore, both the Department of

Labor and ERISA caselaw take the position that a person with authority to appoint or remove a fiduciary is *also* a fiduciary and has a fiduciary responsibility to act prudently in selecting and monitoring the performance of the appointee and to take corrective action if the appointee ceases to be a prudent choice to serve as fiduciary.[5]

Accordingly, since a company acts in the first instance through its board of directors or other governing body, designating a company as "named fiduciary" typically renders the members of that governing body fiduciaries. (For the sake of convenience, this article assumes that an employer's governing body is a board of directors and uses the appropriate terminology, but the analysis holds true regardless of the design of the governing authority.)[6] If no one else is appointed to carry out fiduciary functions, the board members have full fiduciary responsibility. If they appoint subordinate fiduciaries or delegate some or all of their responsibilities, they still have the fiduciary obligation to monitor their chosen fiduciaries and designees. In addition, Section 405(c) of ERISA forbids a named fiduciary from delegating "trustee responsibilities" (i.e., responsibilities under the plan's trust agreement to manage or control the assets of the plan) to anyone other than the plan's trustee or an "investment manager" (i.e., a bank, insurance company, or registered investment adviser that has acknowledged fiduciary status).[7] Ultimately, this means that the directors need to devote appropriate time and attention to the operation of the plan and the investment of its assets, if they retain direct responsibility, or to the oversight of the individuals they have selected to carry out these responsibilities on the company's behalf.

In the case of a small company whose directors are directly involved in the day-to-day management of the business, this governance structure often makes sense. The directors are accessible and familiar with the company and its employees, and thus have the capacity and insight to discharge their duties to the plan. Furthermore, a small company (depending on its line of business) may not even have other individuals with the necessary skills to oversee the plans and plan vendors.

In the case of a public company, however, or of any other type of business with directors who do not have day-to-day involvement with the business, imposing fiduciary responsibilities on the directors subjects them to unnecessary risk[8] and may even hamper the proper operation of the plans. Scheduling meetings with administrative staff and vendors often prove complicated when directors must attend but are not onsite on a daily basis. In many cases, as well, the directors have so many other demands on their time and attention that it is too easy for benefit plans to receive short shrift. In these circumstances, saddling public company directors with fiduciary responsibilities not only gives a plaintiff in an ERISA lawsuit the leverage that comes from being able to sue the directors individually, it also presents a picture of plan fiduciaries who have not involved themselves in plan operations to the extent necessary to meet their ERISA responsibilities. That, in turn, leaves the fiduciaries exposed to liability if the plan has suffered losses they could have been prevented with proper oversight. If the plan invests in company stock, directors' access to material nonpublic information poses additional complications, as discussed later.

Accordingly, an employer needs to consider the desired identity of its named fiduciary carefully. If the plan document does not align with its preferences, it should ask its document vendor whether it can change those provisions. The plan document itself, by its terms, must identify the desired person or persons (or committee) as the named fiduciary. If the document names the company and the company (acting through its board or through someone to whom the board has delegated authority) then charters a benefits committee to operate the plan or adopts resolutions delegating authority, the company (and its board) are still fiduciaries responsible for overseeing the appointed committee members or other individual(s).[9] In contrast, if the plan document identifies an employee or a set of employees (by name or title) to serve as named fiduciary, or states that a committee to be appointed by a specified person (identified by name or job title) will be the named fiduciary, then only those individuals are fiduciaries.[10]

Unfortunately, not all documents give an employer this level of flexibility. Although the IRS recently confirmed that revisions to a plan's administrative provisions will not affect a qualified retirement plan's ability to use an IRS-preapproved document,[11] and although IRS preapproval is not an issue for qualified retirement plans using individually designed documents, welfare plans, or nonqualified deferred compensation plans, some document vendors will not permit alteration of their documents' governance provisions. Even if a document can be amended, doing so may be time-consuming and cumbersome, if the document has numerous references to the employer in a fiduciary capacity that need to be adapted.[12] An employer will need to review its options with its document provider. Once a decision is made, the employer must make sure that anyone who has a "named fiduciary" role, or who will be acting on behalf of the company as named fiduciary, understands and carries out his or her responsibilities.

Who Should Be the Named Fiduciary?

If the company will not be the named fiduciary, whom should the company select to fill this important role? In most cases, an employer will establish one or more committees to serve as the plan's fiduciary(ies). A committee is preferable to identifying a single employee. The involvement of multiple employees prevents a single employee's departure from leaving a plan without an available fiduciary, and allows for continuity when individual fiduciaries leave the company or transition out of the fiduciary job. In addition, if an individual serving as sole fiduciary develops a dispute with the plan, resolving that dispute within the confines of the plan's governance structure may be difficult.

Number of Committees

Some companies use a single committee for all plans, while others may use a separate committee for health and welfare plans on the one hand, and retirement plans on the other, or even appoint separate committees for separate plans. Still other companies use one committee for benefits administration, and one or more other committees for investment oversight. As a result, a plan may have more than one named fiduciary, each with a distinct role.[13] In some cases, different subsidiaries may establish separate committees. The size of the company, the complexity of its benefit arrangements, and the availability of personnel with desired skills will drive this decision; there is no single "best" approach.[14]

Identifying the Committee Members

The plan document may identify the individuals to serve on the committee, either by name or by job title. Normally, using job titles with language that allows for replacement of an identified title by someone holding a successor title or acting in the capacity of the named position is preferable, since it minimizes the need for frequent plan amendments and accommodates ordinary changes in company personnel. As a further refinement of this design, which is especially helpful for companies that change job titles frequently or that want flexibility in committee membership, a plan may identify one or two individuals as an "appointing fiduciary" empowered to appoint committee members in turn. For example, a plan document may call for the "Senior Vice President of Human Resources, or the person holding a successor title or acting in such capacity" to serve as appointing fiduciary and name the committee members.

Ultimately, an employer or other appointing fiduciary selecting individuals to serve on a committee should consider the following:

- Will the chosen individuals be able to meet with the desired frequency? Will they have enough time to prepare for meetings and carry out any responsibilities requiring their involvement between meetings?

- Do the chosen individuals have sufficient expertise to carry out their duties, taking into account the professional assistance that will be available to them?

- Do the chosen individuals understand the role the plan plays in the employer's business and the needs of plan participants?

As is the case with committee structure, the number of individuals serving on committees varies from company to company. Committee sizes most often range from three to five,[15] since that number generally is large enough to provide some redundancy and continuity in the case of routine personnel changes while being small enough to allow the scheduling of meetings with appropriate frequency. Except in the case of multiemployer plans required to have an equal number of labor and management votes on the joint board of trustees, most employers favor an odd number of committee members, to prevent the risk of a deadlock. As a practical matter, however, fiduciary committees typically prefer unanimous consensus, and strive to resolve differences rather than to settle disputes by majority vote. Accordingly, having the right people on a committee generally is more important than the specific number.

Of course, if a plan document requires that a specific number of people be on the committee, the committee must operate accordingly. To prevent an unnecessary breach of the plan's terms, a plan whose committee members are not directly appointed by the plan document usually should avoid specifying the number of members, and at the least should authorize the committee's operations to continue notwithstanding a vacancy.

Role of Counsel

Some plans have the company's attorney serve as a member of the fiduciary committee. Although this provides the committee the advantage of legal expertise and helps to ensure the attorney is well informed about and engaged in the committee's activities, the attorney's presence will *not* convert committee meetings into privileged legal discussions. It is often preferable to have an employee benefits attorney attend meetings but not serve as a voting member, in order to avoid the potential for confusion between decisions made by an attorney-fiduciary in his or her fiduciary role and legal advice.

In addition, appointing the attorney as a committee member may pose complications for the attorney's role as counsel. An attorney serving as a voting member may be unable to represent the plan or company should disputes arise regarding the committee's activities. This is less of a concern if the lawyer in question is one member of a legal department with others capable of taking on this role than it may be for a sole general counsel or an outside law firm, but still can present an inconvenience in the event of litigation.

Furthermore, if the plan has employer stock, an attorney-fiduciary may face a conflict between ERISA obligations and insider-trading restrictions, as discussed later, or between his or her fiduciary obligations to the plan and his or her obligations to the company as its attorney. For example, if the attorney has been consulted by corporate management because concerns have arisen regarding the accuracy of the company's securities filings, the attorney's view of the best course of action for the company may not align with the best interests of the plan.

Regardless of whether counsel is simply in attendance or is acting as a member, the attorney and all the committee members and other meeting attendees should be aware of the limitations of attorney-client privilege in the benefit plan arena.[16] For the most part, activities and discussions related to fulfillment of the committee's fiduciary role are not privileged, at least not as against the plan participants and government regulatory agencies representing their interests. Courts typically subject these functions to the "fiduciary exception" to the attorney-client privilege.[17] In contrast, legal advice connected to plan design decisions[18] and/or to potential fiduciary liability[19] generally will be privileged. Disputes with individual participants (or classes of participants) may at some point in their development become entitled to privilege, although courts vary as to the circumstances in which privilege will attach.[20] And of course, as always, a communication is not privileged unless it is a *confidential* communication that was *intended to provide (or enable the attorney to provide) legal advice to a client*.[21] Other types of communications are not privileged, and neither are communications that are not kept confidential. Likewise, underlying facts do not become privileged simply because they are shared with a lawyer.

The committee members also need to bear in mind that even when the attorney is acting as an attorney, the attorney typically is acting as counsel to the company and/or the plan. As such, the attorney may provide legal advice to the members for the benefit of the company with respect to the members' employment duties, or to the members in their fiduciary capacities for the benefit of the plan. In contrast, the attorney normally does not represent the members themselves. Should concerns about individual liability arise, the members may need their own counsel.

Who Should Be the Appointing Fiduciary?

Deciding on the appropriate person to serve as appointing fiduciary involves a similar analysis to the approach outlined above for selecting committee members. The appointing fiduciary should have the time, availability, and expertise to evaluate the qualifications of potential committee members and oversee their performance of their duties.

In some cases, the appointing fiduciary may appoint himself or herself to the committee, or attend committee meetings some or all of the time as an observer. In other cases, the appointing fiduciary may attend an occasional meeting, or oversee committee performance by written or oral reports. Regardless, however, the appointing fiduciary should be sure the committee maintains a record of his or her oversight activities in its files. Busy fiduciaries often overlook the need for documentation, but documentation will be essential if the appointing fiduciary ends up as the defendant in a lawsuit accusing him or her of failing to monitor the committee.

Special Considerations for Plans with Employer Stock Investments

Investing in employer stock poses special hazards for plan fiduciaries. If the stock price drops (even temporarily), plan fiduciaries may be sued for having failed to protect plan participants.[22] If the stock price rises significantly after a divestiture of some or all of the plan's stock, fiduciaries can be sued for having deprived participants of the opportunity to share in the price improvement.[23]

Insider Information

If a plan invests in employer stock, ensuring that board members, senior officers, and other individuals likely to have inside information regarding the employer's business are *not* plan fiduciaries can help prevent potential conflicts between ERISA's requirement that fiduciaries act prudently in the participants' exclusive interest, on the one hand, and insider trading rules, on the other hand. Recent caselaw in the wake of the Supreme Court's *Fifth Third Bancorp v. Dudenhoeffer*[24] and *Amgen Inc. v. Harris*[25] decisions has set an extremely high bar for plaintiffs seeking to hold fiduciaries accountable for non-use of insider information—a bar that plaintiffs have yet to clear in a case involving a public company, although that has not stopped plaintiffs from trying.[26]

Avoiding situations in which fiduciaries have insider information not only avoids placing fiduciaries between the rock of ERISA obligations and the hard place of insider trading prohibitions, it also removes this claim from plaintiffs' toolbox. If the fiduciaries did not know the problematic inside information, there is no need to debate whether they could have done something in response to it that, as *Amgen* requires, would not have done "more harm than good." In addition, avoiding fiduciary roles for these individuals helps prevent high-ranking officers and directors from facing a conflict between the company's best interests for investor relations and long-term survival and the plan's best interests. Finally, avoiding fiduciary status means that a company officer or director who does find himself or herself in the crosshairs of a securities investigation or lawsuit will not also need to defend an ERISA claim regarding the alleged disclosure violations and associated actions or inactions.

Private Companies

Private companies are not subject to the insider trading rules that govern public companies, so they do not face the same level of concern in connection with insider knowledge. They also often lack qualified individuals to serve as fiduciaries who are not intimately familiar with the business' projected performance. However, senior management members serving as fiduciaries may encounter situations where their personal interests or those of the business conflict with the plan's. Accordingly, as always, the fiduciaries must be careful to understand the constraints under which they have to operate. If conflicts of interest are unavoidable, the plan's named fiduciaries may need or want to hire an independent fiduciary.

In assessing the risks associated with employer stock investments, fiduciaries of private-company plans with stock should also bear in mind that recent caselaw following the Supreme Court's *Dudenhoeffer* decision may not offer them the same level of protection it has offered to public companies. The *Dudenhoeffer* decision was premised on the efficient market hypothesis, and asserted that "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."[27] Subsequent public company cases have largely equated accurate pricing of the stock via the market with a finding that investment in the stock at that price with retirement plan assets was prudent.[28] Private companies by definition do not trade in an efficient market. Hence, private company fiduciaries cannot rely on the argument that the market confirmed the value of the stock held by the plan and that, *ipso facto,* investment at that price was prudent. Although some courts have nonetheless taken a *Dudenhoeffer*-type approach to at least some aspects of ERISA challenges to private company employee stock option plan (ESOP) transactions,[29] the scope of fiduciary responsibilities in this context remains at best debatable.

Aligning the Documentation

As noted above, the employer must draft its plan document to reflect its chosen named fiduciary. Contradictory provisions that place fiduciary responsibilities with the employer, the employer's board, or other people whom the employer does not intend to function as fiduciaries expose the relevant people to the risk of fiduciary liability.[30] A plaintiff can point to those clauses of the plan document and assert that the relevant person should be liable for having failed to discharge the stated function.

In addition, the employer and the plan fiduciaries will need to review other documents associated with the plan and make sure those documents, in turn, are consistent with the desired fiduciary structure. Frequently affected documents include:

- Summary plan description
- Trust agreement
- Insurance contracts
- Service agreements
- Informal plan communications, such as enrollment materials and "highlights" brochures

In many cases, insurance and service agreements form a major stumbling block. While it is acceptable (and often necessary) for the employer in its role as plan sponsor to be a party to these documents, the employer's role should be expressly limited to plan sponsor functions (such as plan amendment/termination and the provision of employment data from its records) and indemnification of the vendor. Fiduciary functions, such as approval of the vendor's terms of service, fees, and termination of the agreement, must be the responsibility of the relevant plan fiduciary. If it is not possible for the employer to negotiate a contract that reflects these limitations, the employer should at least seek to include a "patch" in the plan document confirming that any fiduciary functions assigned to the employer by the plan's various contracts may be exercised only at the direction and as the agent of the proper plan fiduciary.

PLAN ADMINISTRATOR

Section 3(16) of ERISA and Section 414(g) of the Internal Revenue Code of 1986 as amended (the Code) state that the plan administrator is the person named as such "by the terms of the instrument under which the plan is operated," and that in the absence of a named administrator, the plan sponsor is the administrator. The "plan sponsor," in turn, is the employer or, in the case of a multiemployer plan with a joint labor-management board of trustees, the joint board.

Employers often make the error of assuming that their insurance company, recordkeeper, claims administrator, or third-party administrator is the "plan administrator." This is a logical supposition; typically, one of these vendors operates (i.e., in ordinary English, "administers") the plan on a day-to-day basis. In a small minority of cases, this supposition is even correct, since some consultants and recordkeepers will offer (for an appropriate fee) to serve as the official "plan administrator." In most cases, however, a cursory read of the vendor's contract will generally turn up an express disclaimer of "plan administrator" status. These vendors perform only the "ministerial" tasks of plan operation, following the instructions of the plan document and the plan's official plan administrator and named fiduciary(ies).[31] "[A] person who performs purely ministerial functions … within a framework of policies, interpretations, rules, practices, and procedures made by other persons is not a fiduciary because such person does not have discretionary authority or discretionary control respecting management of the plan, does not exercise any authority or control respecting management or disposition of the assets of the plan, and does not render investment advice with respect to any money or other property of the plan and has no authority or responsibility to do so."[32]

In contrast, the plan administrator is a plan fiduciary by definition.[33] Accordingly, a person empowered to appoint or remove the "plan administrator" also automatically is a fiduciary. Anyone serving as plan administrator or appointing the plan administrator (or the members of a committee serving as plan administrator) needs to operate in accordance with ERISA's standard of prudent care.

In addition to the general risk of liability applicable to all fiduciaries, the plan administrator can be assessed a variety of civil and/or tax penalties if he, she, or it fails to discharge certain statutory obligations. For instance, under Section 502(c) of ERISA, failure to respond in a timely fashion to a participant document request can generate penalties of up to $110 a day. As another example, the maximum penalty for failure to file Form 5500 currently stands at $2,140 per day.

Choosing the Plan Administrator

As in the case of the named fiduciary, most "off-the-shelf" documents provide for the employer to be the plan administrator. In contrast to the more limited design options often available for the named fiduciary, however, many allow an employer to write in an overriding designation of someone else as plan administrator.

For the most part, the decision of who should serve as plan administrator follows the same analysis that applies to the selection of a named fiduciary. Indeed, for the vast majority of plans, the plan administrator and the named fiduciary are the same person. There is, however, one potentially significant additional consideration. Since most courts have agreed that the statutory penalties discussed above for failure to discharge various plan administrator duties apply *only* to the plan administrator, and *not* to individuals empowered to appoint or remove the plan administrators or subordinates to whom the ministerial aspects of plan administration have been delegated,[34] there is some advantage to having the employer entity serve as plan administrator. With the business entity as the named plan administrator, individuals are protected from these potential liabilities.

However, if the employer opts to name itself as plan administrator, the individuals who carry out its fiduciary duties as plan administrator, and those individuals with the power to select those individuals, are plan fiduciaries subject to personal liability under Sections 409 and 502(a)(2) of ERISA. This rule, therefore, brings the board of directors back into the fiduciary chain of command and back into potential exposure to fiduciary breach litigation and liability. If the plan holds employer stock, involvement by corporate insiders also raises the risk of ERISA claims attaching to what are intended to be corporate disclosures. For this reason, naming an individual or committee as plan administrator and providing for appropriate protection against penalties arising from error or ignorance (as opposed to misconduct) with indemnity and insurance generally is preferable for large companies (especially those offering investment in employer stock) and any other organization whose board is unsuited or unwilling to engage with plan operations.

Naming the Plan Administrator

As was the case for an employer seeking to designate an individual or committee as named fiduciary, the employer needs to be sure that all provisions of the plan document are consistent with the selected plan administrator's status as such. In addition, the plan administrator must be identified in the summary plan description, on Form 5500 (which will typically require obtaining an employer identification number for the plan administrator), and in various plan communications. Many vendors simply assume that the employer is the plan administrator and complete these documents accordingly. The employer's staff should proofread all filings and communications in any event. As part of that process, they should check that plan administrator contact information is accurate.

OUTSOURCING

Even the very largest employers blessed with sizeable in-house benefits departments outsource some aspects of benefit plan administration, such as actuarial functions, software design, investment platforms, and (of course) any required independent audits. Small employers usually outsource the vast majority of plan functions, and many large employers do so as well. Often, outsourcing not only is permissible, it is more cost-effective and/or efficient. For example, unless an employer is itself in the business of operating 401(k) plans, it would not be efficient (and in most cases, would not be possible) for the employer to construct its own 401(k) platform with daily traded investments, daily valuations, distribution processing capabilities, and so forth. Likewise, selecting an institutional trustee offers a variety of protections and conveniences not available if an individual employee acts as trustee. Nonetheless, the plan's fiduciary in charge of the relevant plan function must make a thoughtful decision about what work should or must be performed in-house, and must select a cost-effective, qualified vendor for any work it decides to outsource.

Selecting a Vendor

While the fiduciary need not select the cheapest vendor if it feels that a different vendor offers a higher level of quality, additional services, or other advantages that justify a higher price,[35] Section 408(b)(2) of ERISA prohibits a plan from paying in excess of a reasonable price. Accordingly, fiduciaries must determine what constitutes a reasonable price.

For relationships that involve significant costs, long-term services, or otherwise are material to the plan's operations, the fiduciary typically should conduct a formal Request for Proposal process. Plan designs, fiduciary and sponsor priorities, plan demographics, and other factors vary widely among plans, and a Request for Proposal is usually the best way to facilitate an apples-to-apples comparison among vendors and identify arrangements suited to the specific plan.

Indeed, the Request for Proposal process does much more than lay the groundwork for a defense against charges that a fiduciary overpaid for a service or negligently selected an incompetent vendor. The process gives the fiduciary a chance to meet the vendor, think about desired services in detail, and gain comfort that he or she is selecting someone who will provide a positive working relationship. In many cases, a plan could obtain adequate, cost-effective service from more than one vendor, and will find various combinations of services and support on offer. A formal Request for Proposal process maximizes the odds that the fiduciary will identify the vendor with the combination of pricing, services, and personnel that best meets the needs of the fiduciary's particular plan and participants. Often overlooked, but very important in the long run, the process will also give the *vendor* the opportunity to set an appropriate price. While plan fiduciaries need to be cautious not to overpay, underpaying a vendor can result in poor service, fraught interactions, and the resulting need to make a disruptive vendor change sooner than the fiduciary would otherwise have hoped. Generally, the interests of plan participants are best served when a relationship is fair to all parties involved.

However, fiduciaries should balance the desire for comprehensive data against the time and expense of a Request for Proposal process, consider the extent to which vendors are willing to bid, decide which vendor relationships merit this effort, and consider how often the process should take place. Even if a full Request for Proposal process is not practical, a fiduciary who is selecting a new vendor typically can obtain at least a few competing bids or engage in some other form of price and service benchmarking. The fiduciary also should establish a schedule for periodically benchmarking existing relationships to see if a Request for Proposal or some other more in-depth form of benchmarking is warranted. There may be some exceptions to this rule of thumb, but the fiduciary should start from this premise and document any decision that a Request for Proposal or other benchmarking process is not necessary.

Questions to Consider

When interviewing vendors and negotiating service contracts, the key points for discussion are, of course, services (or products, as the case may be) and price. For example, a fiduciary hiring a medical insurer wants to know what medical products and services are covered and what the premiums will be. A fiduciary hiring a 401(k) plan recordkeeper wants to know what plan investment options will be available; whether the recordkeeper will perform functions such as service tracking, contribution calculation and distribution issuance; and how much the plan will have to pay. However, plan fiduciaries should also bear in mind the same sorts of questions that any businessperson entering into a contract will want to address, such as:

- Indemnification clauses (in favor of and against the vendor)

- Dispute resolution and forum selection clauses
- Confidentiality
- Cybersecurity
- Quality control metrics (and penalties if established benchmarks are not met)
- Amendment clauses, particularly any provisions that give the vendor the right to unilaterally change key terms[36]
- Termination clauses, especially provisions that allow the vendor to terminate the agreement on short notice and perhaps leave the plan in the lurch or, conversely, clauses that may violate ERISA's prohibition on excessively lengthy contractual commitments[37]
- Situations likely to generate extra fees, details of how those fees are calculated, and provisions for alerting the fiduciary before extra fees are incurred

In-House Staff, Products, and Services

Even if an employer has outsourced the bulk of the plan administrative responsibilities, some level of employer interaction still will be necessary. For example, in most cases, a vendor will not know when an employee has been hired or terminated unless an employer contact person provides this information. Furthermore, the employer-fiduciaries who selected the vendors remain responsible for monitoring the quality of their performance and taking corrective action as needed. For long-term relationships, the employer-fiduciaries periodically need to reassess the reasonableness of pricing and the suitability of the overall relationship. Accordingly, the employer must be sure that any staff members working with the plans are familiar with their responsibilities under the law and under the specific terms of the employer's plans. That means, among other things, that staff should have copies of and actually read the plan documents, and should undergo appropriate training.[38]

Businesses engaged directly in the benefit plan industry face special considerations. While they have the advantage of in-house expertise, they also have the potential for conflicts of interest. To the extent that the business provides products and services to its own plan, it must be sure to operate within the confines of ERISA's "prohibited transaction" rules.[39] To provide a very basic description of very complicated rules, the "prohibited transaction" rules generally prohibit anyone affiliated with a plan sponsor, service provider, or fiduciary from dealing with plan assets for his/her/its own benefit, from exercising fiduciary discretion for his/her/its own benefit, and from engaging in transactions with the plan except within specified parameters. The upshot of these rules is that employers generally cannot profit by providing services or products to their own plans, although they can in most cases provide the service or product at cost. A person who violates these rules can be required to reimburse the plan for any costs or losses associated with the transaction, disgorge any profits, and pay an excise tax.[40]

Some exceptions apply. For example, a financial company is permitted to offer its own mutual funds in its plan and receive its usual management fee from the fund, so long as it adheres to certain safeguards and the mutual fund offering otherwise satisfies ERISA's standards of prudence.[41] However, if an exception is not available, the company must be careful that in-house service or product arrangements do not include a profit component. In addition, as in the case of the mutual funds discussed earlier in this paragraph, the fiduciaries must make sure that their selection of the company's in-house offering is objectively prudent and that any costs reimbursed by the plans are reasonable.

When reimbursing company costs, regardless of whether the company is offering the plan a service that it offers to the general public or providing a special service through dedicated in-house benefits resources, the fiduciaries need to bear in mind that the plan can pay only "direct expenses" and cannot reimburse for "overhead" costs that the company would have incurred in any event.[42] For example, if benefits staff occupy three offices in the company's building, the company cannot charge the plan for a proportional amount of the building rent, mortgage payment, or maintenance costs. However, the Department of Labor has ruled that a company can bill the plan for salary costs associated with employees dedicated to a benefit plan that it would not employ if they were not providing services to the plan.[43] An employer considering taking advantage of this rule should be familiar with the Department's guidance in this area and proceed carefully, since the consequences of violating the prohibited transaction rules can be extremely expensive.

PLAN SPONSOR FUNCTIONS

The discussion to this point in the article has focused on fiduciary functions and the ministerial operational functions carried out under fiduciary oversight. However, an employer should also consider who will make decisions and take action on behalf of the business as sponsor of the plan. When making decisions as the sponsor (or settlor) of the plan, the employer is *not* subject to ERISA's fiduciary responsibilities and can act in its own business interests.[44] Nonetheless, any action must be taken by someone properly authorized to act on behalf of the organization and align with the amendment procedures specified by the plan document.[45] Failing to adhere to the proper governance procedures could lead to disapproval from officers or board members, shareholder discontent and litigation, or invalidity of important (and potentially expensive) plan actions.[46] For example, if the company's chief executive officer takes action to freeze a pension plan but was never authorized by the board of directors to do so, a participant may be able to challenge that action years later and force retroactive reinstatement of pension benefit accruals.

In deciding who should be empowered to make what decisions, a company will need to consider any state law rules not preempted by ERISA, its governing documents, and its particular needs and culture. For example, a large public company will not want to have to seek formal board approval to increase the number of days per covered hospital stay under its medical plan, but may want to be sure that officers cannot terminate a multibillion-dollar pension plan or adopt a retiree medical benefit program without approval from the board or the board's compensation committee. In that case, the board might delegate the ability to make changes that do not exceed a specified cost level to one or more officers, but reserve to the board or its compensation committee the authority to make changes above that level as well as any actions dealing with certain types of plans or benefits that present particular concerns for that company.

Whatever governance structure a company selects, it should document any delegations of authority. The company also needs to make sure that actions taken are duly authorized in accordance with those delegations and that it retains documentation of the approval. Depending on the company's process, documentation may include signed amendments, board minutes or resolutions, or some other form of paperwork. In this regard, the employer should bear in mind that health and welfare plans are also "plans," and not reserve the formalities just for the retirement plans. The employer will also need to pay attention to any communications it receives from its plan document vendors. Amendments to plan documents often need to be approved by specific deadlines, and documentation of that approval must be retained in the plan's files.

CONCLUSION

The decision to establish a plan is never one to make lightly, and the choices and requirements only get more complex as the plan becomes operational. Thinking carefully about how the plan will operate and who will do the operating is essential to protect the employer and its employees who oversee the plan, as well as to enable successful provision of the intended plan benefits.

NOTES

1. *Fort Halifax Packing Co. v. Coyne,* 482 U.S. 1, 9107 S. Ct. 2211, 2216, 96 L. Ed. 2d 1, 10 (1987).

2. *See, generally,* Jacklyn Wille, "Employee Benefit Class Settlements Gleaned Over $500 Million in 2017," *Pension & Benefits Daily* (January 23, 2018).

3. Section 402(a)(2) of ERISA.

4. Multiemployer plans, typically required by law to be operated by a joint board of labor and management trustees, constitute the major exception to this historical practice of having a sponsoring employer serve as named fiduciary.

5. 29 C.F.R. 2509.75-8 Q&A D-4; *see, for example, Johnson v. Couturier*, 572 F.3d 1067 (9th Cir. 2009) (directors who have responsibility to appoint and remove ERISA trustees are fiduciaries, albeit only with respect to those functions); *Carr v. Int'l Game Tech*., 770 F. Supp. 2d 1080 (D. Nev. 2011) (merely overseeing plan communications does not impose fiduciary status, but authority to appoint fiduciaries made directors fiduciaries); *c.f. Perez v. Bruister*, 823 F.3d 250 (5th Cir. 2016) (asserting that Fifth Circuit has not acknowledged "failure to monitor" liability but merely allowed the possibility of *respondeat superior* liability for knowing and active participation in an agent's breach); *In re BP P.L.C. Sec. Litig*., No. MDL No. 4:10-MD-2185, 2015 U.S. Dist. LEXIS 147819 (S. D. Tex. Oct. 30, 2015) (confirming that plan sponsorship did not confer fiduciary status and denying appointing-fiduciary status arising merely from appointment of employees to employment roles that included plan responsibilities; denying that Fifth Circuit's heightened standard for *respondeat superior* in ERISA cases had been met when alleged superiors had not knowingly or actively participated in alleged breach or exercised requisite control over agent and noting that for the most part sufficient involvement to enable a claim of *respondeat superior* will occur only when superior is also itself a fiduciary); *Howell v. Motorola, Inc*., 337 F. Supp. 2d 1079, 1092–1094 (N.D. Ill. 2004) (allowing claim against directors with appointment authority for failure to monitor; but holding that plaintiffs had not adequately alleged that company had such a role and hence had not adequately alleged that it was as a fiduciary; going on to permit on a preliminary basis a theory of *respondeat superior* liability against company itself; surveying cases on *respondeat superior* theory in ERISA context and noting division of authority on its viability).

6. In some cases, an entity's governing authority may be another entity. For example, a subsidiary may be a single-member LLC with a corporate member authorized to act as its manager. In that case, the fiduciary responsibility (and liability) keeps moving up the chain of command until it reaches individual humans.

7. Section 3(38) of ERISA.

8. *See* Lars C. Golumbic, *Who May Sue You and Why: How to Reduce Your ERISA Risks, and the Role of Fiduciary Liability Insurance (A Chubb Special Report)* (June 2017) (visited February 9, 2018), *<https://www2.chubb.com/us-en/_assets/*

doc/170101202-erisa-risks-&-role-of-fiduciary-liability-insurance-07.17.pdf>; John J. Cannon III and Kenneth J. Laverriere, "Just Say No: Why Directors Should Avoid Duties That Will Subject Them to ERISA," *Pension & Benefits Reporter*, Vol. 42, No. 9, 475–477.

9. *See* Cannon and Laverriere, *supra* n.8.

10. *See, for example*, cases discussed *supra* n.5, especially *In re BP P.L.C. Sec. Litig.*; *Houssain v. Chenault*, 15 Civ. 8184 (PGG) (S.D.N.Y. September 28, 2017). <*https://www.bloomberglaw.com/public/desktop/document/Houssain_v_Chenault_et_al_Docket_No_115cv08184_SDNY_Oct_16_2015_C/1?1517700922*>.

11. Revenue Procedure 2017-41, 2017-29 I.R.B.

12. It has become more common in recent years for document vendors to acknowledge the growing demand for governance structure flexibility by using a "fill-in-the-blank" definition for the "named fiduciary" rather than automatically naming the sponsoring employer. However, many vendors do not carry this concept through the complete document. The documents often retain problematic references to an employer performing fiduciary functions (such as references to a plan's investment options being selected by the employer), or refer to the employer as "delegating authority to" or "appointing" the named fiduciary. In other cases, documents may simply be unclear about who one or more fiduciaries are and how they are appointed, meaning that the employer needs to interject itself into the fiduciary identification process as a matter of practicality. Therefore, an employer seeking to clarify its governance structure needs to have ERISA counsel conduct a thorough review of the plan document.

13. Pursuant to Section 405 of ERISA, if specific fiduciary duties are allocated to different fiduciaries, each fiduciary generally will be liable only for the duties allocated to it. In those circumstances, a fiduciary will be liable for a breach of duty by a co-fiduciary only if the second fiduciary participates knowingly in, or knowingly undertakes to conceal, the breach, enables the breach by his/her own breach of duty, or knows of a breach and fails to make reasonable efforts to remedy the breach.

14. *See, for example, Unlocking Value from Effective Retirement Plan Governance: The 2016 Willis Towers Watson U.S. Retirement Plan Governance Survey* (2016) (visited February 3, 2018), <*https://www.willistowerswatson.com/en/insights/2016/05/strategies-in-retirement-plan-governance*>.

15. *See 2016 Willis Towers Watson U.S. Retirement Plan Governance Survey, supra* n.14, at 6 (average committee size 4.7).

16. *See, generally,* Leslie E. DesMarteau, "Employee Benefits Exceptions to Attorney-Client Confidentiality (and the Exceptions to the Exceptions)," *Benefits Law Journal*, Vol. 23, No. 3 (Autumn 2010).

17. *See, for example, Washington-Baltimore Newspaper Guild, Local 35 v. The Washington Star Company,* 543 F. Supp. 906, 910 (D. D.C. 1982).

18. *In re Long Island Lighting Co.*,129 F.3d 268, 272 (2d Cir. 1997).

19. *See U.S. v. Mett*, 178 F.3d 1058 (9th Cir. 1999).

20. *C.f., for example*, *Geissal v. Moore Medical Corp.*, 192 F.R.D. 620 (E.D. Mo. 2000) and *Tatum v. R.J. Reynolds Tobacco Co.*, 247 F.R.D. 488 (M.D. N.C. 2008).

21. *See Upjohn Co. v. U.S.*, 449 U.S. 383, 389, 101 S. Ct. 677, 66 L. Ed. 2d 544 (1981).

22. *See, for example, Fifth Third Bancorp v Dudenhoeffer*, ___US___, 134 S. Ct. 2459, 189 L. Ed. 2d 457 (2014); *see, generally,* Corey Rosen, "The Year in Employer Stock Litigation," *Pension & Benefits Reporter* Vol. 44, No. 46 1387 (November 21, 2017) (reviewing a number of cases; while the article notes that "stock drop" claims have generally been unsuccessful, readers should bear in mind that all of these resulted in expenditure of defendants' time and money, and no doubt caused significant stress for individual fiduciaries).

23. *See, for example*, *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346 (4th Cir. 2014) (this ruling represents one decision in a long-running lawsuit involving the fiduciaries' sale of R.J. Reynolds stock while the stock price was at a low point); Jacklyn Wille, *Wawa* Inks $25M Deal in Challenge to Forced Stock Sell-Off, Pension & Benefits Reporter Vol. 45 No. 2 49 (January 9, 2018).

24. *Fifth Third Bancorp v. Dudenhoeffer*, ___ U.S.___, 134 S. Ct. 2459, 189 L. Ed. 2d 457 (2014).

25. *Amgen Inc. v. Harris,*____ U.S. ____, 136 S. Ct. 758, 193 L. Ed. 2d 696 (2016).

26. *See, for example,* Rosen, *supra* n.22; Jacklyn Wille, *HP Scores 9*th *Cir. Win in Challenge to Stock in 401(k) Plan*, Pension & Benefits Reporter Vol. 45, No. 3 13 (January 16, 2018) (collecting list of cases recently resolved in favor of employers).

27. *Dudenhoeffer,supra* n.24, 134 S. Ct. at 2471.

28. *See*, for example, *Rinehart v. Lehman Bros. Holdings Inc*., 817 F.3d 56 (2d Cir. 2016).

29. *See Hill v. Hill Bros. Constr. Co.,* No. 3:14CV213-SA-SAA, 2016 U.S. Dist. LEXIS 40225 (N.D. Miss. Mar. 28, 2016); *Fish v. Greatbanc Tr. Co.*, No. 09 C 1668, 2016 U.S. Dist. LEXIS 137351 (N.D. Ill. September 1, 2016).

30. *In re BP P.L.C. Sec. Litig.*, *supra* n.5, the plaintiffs pointed to an investment management agreement as demonstrating the company's fiduciary status. The defendants explained that the investment management agreement was outdated, and that the company no longer had fiduciary status. The court concluded that there was no evidence that the plan sponsor had in fact acted as a fiduciary, that the investment management agreement was not a governing plan document, and that subsequent amendments reflected the proper fiduciary authority (i.e., the investment committee named by the plan document). Accordingly, the court dismissed the claims. However, the defendants could have avoided this risk by updating their documentation in the first place.

31. To the extent a vendor has actual authority to decide claims without recourse to a final decision from the employer, the vendor will be a fiduciary for that purpose. This commonly arises in connection with insurance companies deciding claims under their insurance policies, and with claims administrators for self-insured welfare plans if the employer has not reserved the authority to override the vendor. These claims vendors are not, however, general-purpose plan administrators.

32. 29 C.F.R. 2509.75-8 Q&A D-2.

33. 29 C.F.R. 2509.75-8 Q&A D-3.

34. *See, for example,*, *Caffey v. Unum Life Ins. Co*., 302 F.3d 576 (6th Cir. 2002) (insurance company not plan administrator; not liable for penalties); *McKinsey v. Sentry Ins*., 986 F.2d 401 (10th Cir. 1993) (claim could not be asserted against entity that was not "plan administrator").

35. The US Department of Labor has confirmed that fees should not be considered in a vacuum, since fees "are only one part of the bigger picture including investment risks and returns and the extent and quality of services provided." *A Look at 401(k) Fees*, (August 2013), p. 9 (visited February 10, 2018) <*https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/publications/a-look-at-401k-plan-fees.pdf*>.The Department require that a warning to this effect be included in disclosures to participants regarding defined contribution plan fees (*see* 29 C.F.R. 2550.404a-5(d)(1)(iv)(4)).

36. Clauses of this type require careful review. A vendor that gives itself the right to change its fees or other key contract provisions unilaterally without a realistic right for the plan fiduciary to end the contract before the alterations take effect may have converted itself into a plan fiduciary (at least if it actually exercises that right) and may therefore have committed a cardinal ERISA sin. Section 406 of ERISA prohibits plan service providers and in particular fiduciaries from dealing with plan assets for their own benefit, and a fiduciary that has just set its own fee has in most cases violated that prohibition. *See* 29 C.F.R. 2550.408b-2(e).

37. 29 C.F.R. 2550.408b-2(c)(3).

38. Department of Labor auditors may inquire about the adequacy of education for fiduciaries and staff.

39. Sections 406–408 of ERISA. Section 4975 of the Code also imposes excise taxes on "disqualified persons" who violate the prohibited transaction rules.

40. *See* Sections 409 and 502(a)(2) of ERISA; Section 4975 of the Code.

41. *See* PTE 1977-03, 42 Fed. Reg. 18734 (April 8, 1977). While the exemption means that proprietary mutual funds can be included as plan investments without violating the prohibited transaction rules, a company ignores the "prudence" caveat at its peril. Numerous fund companies recently have been or currently are the subject of lawsuits alleging that they loaded their plans with proprietary overpriced, underperforming funds. *See* Carmen Castro-Pagan, *Huntington Bancshares, Execs Sued Over High Fees in 401(k) Plan*, Pension & Benefits Reporter Vol. 45 No. 2 53 (January 9, 2018) (discussing allegations that Huntington Bancshares filled the company's 401(k) plan with "high-fee, poorly performing in-house funds" and listing other recent lawsuits against other financial companies making similar allegations).

42. 29 C.F.R. 2550.408c-2(b)(3).

43. Department of Labor Advisory Opinion 1993-06A (March 11, 1993).

44. *Lockheed Corp. v. Spink*, 517 U.S. 882, 116 S. Ct. 1783, 135 L. Ed. 2d 153 (1996).

45. Section 402(b)(3) of ERISA requires that a plan include a procedure for amending the plan document and identify the person(s) with amendment authority.

46. *See Eckert v. Chauffeurs, Teamsters & Helpers Local Union 776 Profit Sharing Plan*, No. 1:15-CV-1920, 2018 U.S. Dist. LEXIS 12533 (M.D. Pa. Jan. 26, 2018); (finding that plaintiffs had submitted adequate documentation that union executive board in fact approved amendment); *Johannssen v. Dist. No. 1 - Pac. Coast Dist., MEBA Pension Plan*, 136 F. Supp. 2d 480 (D. Md. 2001) (finding that amendment was valid under amendment procedure specified in plan; plan administrator's directive that amendment not be enforced was invalid since she lacked authority to amend the plan or to disregard valid amendments); *Collins v. Seafarers Pension Trust*, 846 F2d 936 (4th Cir. 1988) (amendment invalid since trustees failed to follow legally required amendment process).