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**Managing and Assessing  
Service Providers  
in Pension Plans**

**By  
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David is a partner with the US law firm of Kirton McConkie, PC ([kmclaw.com](http://kmclaw.com)). He has more than 35 years of experience in the design, implementation, administration and governmental regulation of domestic and international employee benefit programs, qualified and non qualified private retirement plans, deferred compensation programs, insurance programs and other cash and stock based compensation and benefits programs. His clients are fortune 200 companies in the US and the financial and insurance companies which are the service providers to the benefit plan industry. Globally, he advises private and State Owned Enterprises in the Peoples Republic of China, and enterprises in the European Union, Mexico, India, and the Middle East on employee benefit matters.

David spent over 30 years in Washington DC as a partner in major global law firms. David is a Charter Fellow of the American Bar Association College of Employee Benefits Counsel, and has passed the Certified Public Accounting (CPA) exam. David is the past President of the International Association for Financial Participation ([IAFP.eu.com](http://IAFP.eu.com)), based in Paris, and is the author of the IAFP EU model financial participation plan.



# HISTORICAL BACKGROUND-US PENSION PLANS EVOLUTION FROM PRODUCTIVITY MOTIVATOR TO PRIMARY RETIREMENT VEHICLE

## 1. HISTORICAL BENEFITS OF PENSION PLANS

- **GOOD FOR EMPLOYEES**
  - **FLEXIBLE, PORTABLE, UNDERSTANDABLE, EDUCATIONAL**
- **GOOD FOR EMPLOYERS**
  - **ATTRACT, RETAIN AND MOTIVATE GOOD EMPLOYEES**
  - **INCREASE PRODUCTIVITY**
- **GOOD FOR LOCAL, NATIONAL AND GLOBAL ECONOMY**
  - **INCREASED PRODUCTIVITY MAKES NATIONAL ECONOMY MORE COMPETITIVE GLOBALLY**

## 2. STANDARD OF EMPLOYER'S FIDUCIARY RESPONSIBILITY

- **PRUDENT MAN OR BEST PRACTICE?**
- **BUILDING A DEFENSIVE PERIMETER AGAINST PARTICIPANT AND REGULATOR ENFORCEMENT.**

**STANDARD OF EMPLOYER'S FIDUCIARY RESPONSIBILITY  
PRUDENT MAN OR BEST PRACTICE? OR  
WHO IS LOOKING AT THE ELEPHANT ?**

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Local Roots. Global Reach.



# The Blind Men and the Elephant

American poet John Godfrey Saxe (1816-1887)  
based the following poem on a fable  
which was told in India many years ago.



**It was six men of Indostan  
To learning much inclined,  
Who went to see the Elephant  
(Though all of them were blind),  
That each by observation  
Might satisfy his mind**

**The First approached the Elephant,  
And happening to fall  
Against his broad and sturdy side,  
At once began to bawl:  
“God bless me! but the Elephant  
Is very like a wall!”**

**The Second, feeling of the tusk,  
Cried, “Ho! what have we here  
So very round and smooth and sharp?  
To me 'tis mighty clear  
This wonder of an Elephant  
Is very like a spear!”**

# The Blind Men and the Elephant

American poet John Godfrey Saxe (1816-1887)  
based the following poem on a fable  
which was told in India many years ago.

The Third approached the animal,  
And happening to take  
The squirming trunk within his hands,  
Thus boldly up and spake:  
“I see,” quoth he, “the Elephant  
Is very like a snake!”

The Fourth reached out an eager hand,  
And felt about the knee.  
“What most this wondrous beast is  
like  
Is mighty plain,” quoth he;  
“ ‘Tis clear enough the Elephant  
Is very like a tree!”

The Fifth, who chanced to touch the ear,  
Said: “E’en the blindest man  
Can tell what this resembles most;  
Deny the fact who can  
This marvel of an Elephant  
Is very like a fan!”

Moral:  
So oft in theologic wars,  
The disputants, I ween,  
Rail on in utter ignorance  
Of what each other mean,  
And prate about an Elephant  
Not one of them has seen!

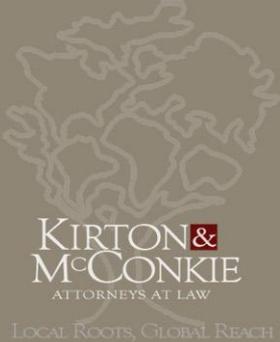


**BUILDING A DEFENSIVE PERIMETER  
AGAINST  
PARTICIPANT AND REGULATOR ENFORCEMENT  
THE “BEST PRACTICE.”**

- **THE FOUR WALLS OF A BEST PRACTICE DEFENSIVE PERIMETER**
  1. **KNOW THE LAW (OR FIND SOMEONE WHO DOES)**
  2. **DEVELOP A DYNAMIC BEST PRACTICE ADMINISTRATIVE SYSTEM (RESOURCE OR OUTSOURCE)**
  3. **FOLLOW THE SYSTEM METICULOUSLY (DEFINE, ASSIGN AND REFINE)**
  4. **AUDIT and BENCHMARK THE SYSTEM (Regularly)**

# TOP TEN BEST FIDUCIARY PRACTICES

- **1. NO GOOD DEED GOES UNPUNISHED** - Don't promise more than you can deliver. Never ever answer this question from an employee "What would you do if you were me?"
- **2. INACTION AND INDECISION ARE A GUILTY PLEA** - It is negligent not to have a system of administration, it may be criminal not to follow it.
- **3. IMPLEMENT ADMINISTRATIVE CONTROLS AND PROCEDURES** - The US Sarbanes-Oxley law (SOX) created a paradigm change in the fiduciary responsibility standard for employers ( best practices replace the prudent man?)
- **4. ALWAYS HAVE AN ANSWER TO THE FOLLOWING TWO QUESTIONS** -
  - Does my pension plan meet applicable laws?
  - Is my plan administered in accord with its terms?
- **5. NETWORK WITH YOUR PEERS** - Find out what best practices your peers are using and consider applying them to your plan.



# TOP TEN BEST FIDUCIARY PRACTICES

- **6. COMPARISON SHOP AND BARGAIN FOR PLAN SERVICES** - Get the right services for the best price, don't accept bundled services you don't need.
- **7. THINK GLOBALLY-ACT LOCALLY** - Think outside the box, use global best practices, but apply them locally to your situation.
- **8. REMEMBER THE SHEPERD'S PRAYER** - When Alan Sheperd, the astronaut, was asked by his crew to pray before blast-off, he said "Lord, don't let me screw this up!"
- **9. REMEMBER THE ELEPHANT**- Who is looking at the elephant? What is their perspective?
- **10. FEEL GOOD-YOU ARE IN THE "DREAM" BUSINESS** - A successful pension plan allows faithful employees to accumulate sufficient resources to make their dreams come true in retirement.



# US SHARE PLAN LAWSUITS

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## THREE BASIC TYPES OF US LAWSUITS

**REGULATORY LAPSES**- These suits are brought by the US Internal Revenue Service (IRS) or Department of Labor (DOL) which have joint responsibility for enforcement of the Employee Retirement Income Security Act of 1974 (ERISA) on behalf of Plan Participants for violations of the law and failure to follow plan terms. Sole remedy issues exist.

**FIDUCIARY BREACHES**-These common law suits are brought by Plan participants for breach of fiduciary duty by plan sponsors, trustees, administrators, boards of directors, company officers and employees etc. This is a developing area of the law in the US and its relationship to Regulatory Lapses, above, is in development.

**US SECURITIES LAW “TAG-ALONG” SUITS**-These suits are brought by ESOP and other “share scheme program” participants and fiduciaries under the US Securities laws on behalf of a class of shareholders of a corporation, which has been harmed by the actions of those associated with the retirement plan’s stock shares. Examples are lack of prudence in investment of plan assets, conflicts of interest between plan duties, shareholder duties and corporate duties, and lack of controls and procedures to adequately monitor actions of plan fiduciaries.



## EXAMPLES OF REGULATORY LAPSES AND FIDUCIARY BREACHES

**REGULATORY LAPSES**-Failure to follow the law or the plan terms leads to a fine by the IRS of up to 20% of the value of plan assets for each violation. Specific regulatory provisions for correction of defect. Many examples of such technical defects.

**FIDUCIARY BREACHES**- Most common current lawsuits involve bundled or hidden fees and lack of disclosure thereof to plan participants, where fees are paid by plan assets.

Caterpillar Corporation-Caterpillar, Inc. has received final approval on its settlement of a 4-year-old lawsuit in which the plaintiffs' claimed the company should have offered cheaper investment options to its plan participants. Caterpillar will pay \$16.5 million to participants in the companies' 401(k) plans. For over ten years, the company offered plan participants a group of mutual funds that were advised by a wholly owned subsidiary, creating an inherent conflict of interest that led to higher fees for participants. While this level of self dealing is rare, it's not wholly unlike structures where investment advisory firms also offer investment management services, and recommend their own products. If Caterpillar had hired an independent plan consultant in the first place they would likely not have been found liable. *Martin v. Caterpillar, Inc.*, Case No. 07-1009, pending the United States District Court for the Central District of Illinois.

### Other Hidden Fee type US cases

ABB  
Exelon  
Kraft Foods  
Radio Schack

Bechtel  
Fidelity  
Int Paper  
United Technologies

Boeing  
General Dynamics  
Lockheed

Deere  
GM  
Northrup

## EXAMPLES OF US SECURITIES LAWS “TAG-ALONG LAWSUIT SETTLEMENTS

**GLOBAL CROSSING CASE-** Five partial settlements totaling approximately \$325,000,000 were reached on behalf of investors who purchased certain Global Crossing or Asia Global Crossing Securities between February 1, 1999, and December 8, 2003, inclusive. Some \$79 million went to the 401k plan participants. The suit alleged that Global Crossing failed to disclose to plan participants adequate information about the true financial position of the company and even encouraged their employees to invest or maintain investments in company stock while placing restrictions on the employees' ability to sell their company stock. Websites are being set up in the US to keep plan participant's advised about such cases. See for example. [http://www.kellersettlements.com/global\\_crossing.html](http://www.kellersettlements.com/global_crossing.html)

### OTHER EXAMPLES OF “TAG-ALONG US SECURITIES LAW SUITS AGAINST SHARE PLAN SPONSORS AND FIDUCIARIES.

Royal Dutch Shell	\$90 Million
Enron	\$\$400 million +
Lucent	\$ 69 Million
Williams Co.	\$55 Million
Bristol Myers	\$41 Million
HealthSouth	\$29 Million
CMS Energy	\$28 Million
Krispy Kreme	\$5 Million

# Prudence or Best Practice ?

Best Practice is always prudent ! Prudence is not always best practice !

Example-

- a. Collective Bargained Plan A has some \$2 Billion (\$2,000,000,000) in assets invested prudently with some ten top quartile managers in disciplines such as fixed income, small cap, large cap, growth, income etc.
- b. The Plan has an investment statement for each investment category with performance benchmarks for each category.
- c. Over the last five years, the managers vary in performance, but on average, 80% of the managers have NOT met their benchmark, which appears to be about average (prudent?) for similar plans.
- d. If a process is available which would identify other managers who are in the 20%, which consistently meet the benchmarks, and you become aware such a process is available, is it imprudent not to use that process for your plan?



# Prudence or Best Practice ?

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- e. In the forgoing example of a \$2 billion plan, the investment difference between a top Quartile manager and a top ten percent manager is estimated to be about 1% per year of lost income or \$20 million per year.
- f. The first question for discussion is whether prudence is an adequate measurement of responsibility, or whether plan sponsors, administrators and other fiduciaries should be held to a higher “BEST PRACTICE” standard?
- g. The second question for discussion is the methods by which a plan sponsor or other fiduciary can identify the best practices available and insure that the plan is being administered both in accord with its terms, and utilizing best practices for administration.

Suggested discussion points:

Periodic independent audit on a privileged basis of

1. Whether plan is administered in accord with its terms.
2. Whether plan is in compliance with local law.
3. Whether best practices are utilized in choosing and retaining plan service providers.