

CAA/IPEBLA Joint Pensions Conference
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Workshop W6: Employer Responsibility For
Plan Administration and Governance

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Employer Responsibility For Plan Administration and Governance

- **Plan Administration Responsibilities Required by IRS and DOL**
- **Compliance with ERISA Fiduciary Rules to Avoid Hidden Fee Litigation**
- **Best Practice Governance**

“Mock IRS Audit”

SAMPLE QUESTIONS

IRS-Required Control Procedures (Employer Responsibility)

1. Do you have procedures to determine if an employee’s service is being properly and timely credited?

Yes No

2. Do you have procedures to ensure that employees are enrolled and participate in the Plan on a timely basis?

Yes No

3. Do you have procedures to ensure that employees are credited with the correct vesting percentage each year?

Yes No

“Mock IRS Audit”

SAMPLE QUESTIONS

4. Do you have procedures in place to ensure that only the appropriate items of compensation are reported to the Plan administrator for purposes of determining the correct amount of

Defined Benefit Pension Plans

- a. participant’s accrued benefit

Yes No

Defined Contribution Plans

- b. 401(k) or 403(b) salary deferral contributions

Yes No

- c. employer matching contributions

Yes No

All Plans

- d. employer contributions other than matching contributions

Yes No

“Mock IRS Audit”

SAMPLE QUESTIONS

5. Do you have procedures to ascertain the employee’s:
- a. date of employment? Yes No
 - b. compensation? Yes No
 - c. account balance or
accrued benefit? Yes No
 - d. birthdate? Yes No
 - e. date of death? Yes No
 - f. other date of termination? Yes No
6. Has the Plan established beneficiary designation procedures, including written spousal consent witnessed by a notary or Plan representative? Yes No
7. Has the Plan established procedures for notifying participants regarding the waiver of the qualified pre-retirement survivor annuity coverage (i.e. death benefit provided when participant dies before payment of benefits begin)? Yes No

“Mock DOL Audit” SAMPLE QUESTIONS

Fiduciary Reporting and Operational Rules

1. Is each participant given a summary plan description?

Yes **No**

a. Do you retain records that each participant received a summary plan description? **Yes** **No**

2. Are 401(k) elective deferrals and/or other employee contributions remitted to the employer as soon as such contributions can be segregated from employer’s general assets but not later than the 15th business day following the month in which such deferrals and/or contribution are withheld or received?

Yes **No**

“Mock DOL Audit”

SAMPLE QUESTIONS

3. Do you have written procedures for reviewing? (check all that apply)
- a. hardship withdrawals Yes No
 - b. Plan loans Yes No
 - c. Qualified domestic relations orders (“QDROs”) Yes No
4. Under your Plan loan program, is a participant’s account balance used as “security” for a loan to the participant? Yes No
5. Do you have a procedure to determine if it is prudent to use the participant’s account balance as “security” for the loan?
- a. at the time the loan is made to the participant? Yes No
 - b. during the term of the loan? Yes No

“Mock DOL Audit”

SAMPLE QUESTIONS

DOL Plan Governance Review

1. Have the Plan fiduciaries adopted a Statement of Investment Policies to be followed by the employer and Investment Manager with respect to the assets for the Plan and Trust?

Yes No

2. Does the named fiduciary submit a report (at least annually) to the Board with respect to plan administration and compliance with ERISA and the IRC?

Yes No

3. Does the Plan have a policy or procedure for the

a. Selection Yes No

b. Retention Yes No

c. Monitoring Yes No

of the Plan’s service providers (consultant, auditor, actuary, counsel, insurer, investment adviser/manager, third party administrator)?

“Mock DOL Audit”

SAMPLE QUESTIONS

4. Does the policy or procedure described in Item 3 above consider the service provider’s

a. Professional credentials Yes No

b. Financial condition including credit or other ratings

Yes No

c. Quality of the service/product Yes No

d. Performance of multiple services for the Plan to avoid conflicts of interest

Yes No

5. Is the performance of the Plan’s service providers reviewed periodically?

Yes No

a. Does the review analyze “reasonableness” of fees?

Yes No

Hidden Fee Litigation

Major Class Action Lawsuits

- **Accusing employers and members of board and senior officers of violating ERISA.**
- **“Allowing” employees to be overcharged by their vendors for administration services and investment management.**
- **Supreme Court in February 2008 unanimously ruled that participants can “individually” sue plan sponsor employers.**

Hidden Fee Law Suits

Named in the suits:

- **The plan sponsor (the employer)**
- **The Named Fiduciary (sometimes a committee, sometimes the employer)**
- **The Named Administrator (also sometimes a committee, sometimes the employer)**
- **Any plan committee or plan investment committee**
- **The Board of Directors**
- **The CEO**
- **The trustee that holds the assets of the plan**

Hidden Fee Law Suits

Hidden Fee Lawsuits:

- **Over 50 cases are currently pending**
- **Claimed fiduciary breaches for failure to**
 - ❑ Investigate service/investment arrangements
 - ❑ Negotiate reasonable total compensation
 - ❑ Monitor service/investment arrangements
 - ❑ Disclosure fees of conflicts of interest

Hidden Fee Litigation

Hidden Fee Lawsuits

- ABB
- Bechtel
- Boeing
- Caterpillar
- Deere
- Exelon
- Fidelity Investments
- General Dynamics
- General Motors
- Kraft Foods Global
- International Paper
- Lockheed Martin Southern
- Northrop Grumman
- RadioShack
- United Technologies

Hidden Fee Litigation

Employer Liable for \$35.2 Million for Failure to Monitor Fees (*Tussey v. ABB, Inc.*, W.D. Mo., 3/31/12 2012 U.S. Dist. Lexis 45240)

- **First 401(k) fee class action to be tried and decided on the merits.**
- **Missouri federal district court ruled that employer plan sponsor breached its ERISA fiduciary duties and must pay \$35.2 million for**
 - failing to monitor recordkeeping fees and revenue sharing payments made to Fidelity;
 - failing to negotiate rebates to offset or reduce the cost of providing administrative services to plan participants; and
 - replacing a Vanguard actively balanced mutual fund with a Fidelity target date fund that generated more in revenue sharing for Fidelity.

Hidden Fee Litigation

Employer Liable for \$35.2 Million for Failure to Monitor Fees
(Tussey v. ABB, Inc., W.D. Mo., 3/31/12 2012 U.S. Dist.
Lexis 45240)

- **Court emphasized that if fiduciary opts for revenue sharing, “it also must have gone through a deliberative process for determining why such a choice is in the Plan’s and participants’ best interest.”**
- **This analysis is particularly critical because Plan’s Investment Policy Statement (“IPS”) required that revenue sharing “be used to offset or reduce the cost of providing administrative services to plan participants.”**
- **Court held that IPS is governing plan document and that employer violated its ERISA Section 404(a)(1)(D) statutory fiduciary duty to comply with its terms.**

Hidden Fee Litigation

Employer Liable for \$35.2 Million for Failure to Monitor Fees (*Tussey v. ABB, Inc.*, W.D. Mo., 3/31/12 2012 U.S. Dist. Lexis 45240)

- **Employer monitoring reasonableness of overall expense ratio insufficient because it does not show**
 - how much revenue is flowing;
 - competitive market for comparable funds; and
 - fails to take into account the size of the plan.
- **Court found that revenue sharing generated by the Plan's assets far exceeded the market value for recordkeeping and other administrative services provided by Fidelity**

Hidden Fee Litigation

Employer Liable for \$35.2 Million for Failure to Monitor Fees (*Tussey v. ABB, Inc.*, W.D. Mo., 3/31/12 2012 U.S. Dist. Lexis 45240)

- **Plan, on average, paid per-participant charges of: \$108 in 2001, \$65 in 2002, \$106 in 2003, \$122 in 2004, \$100 in 2005, \$93 in 2006, and \$180 in 2007.**
- **Court, based on expert testimony, found that reasonable per-participant charge should have been \$60 in 2001, \$65 in 2002, \$70 in 2003, \$68 in 2004, \$63 in 2005, \$60 in 2006, \$44 in 2007.**
- **Court also found that employer deleted Vanguard actively balanced mutual fund, not because of performance concerns, but because Fidelity target date fund that replaced it generated greater revenue sharing.**

Hidden Fee Litigation

Employer Liable for \$35.2 Million for Failure to Monitor Fees (*Tussey v. ABB, Inc.*, W.D. Mo., 3/31/12 2012 U.S. Dist. Lexis 45240)

- **Monetary Relief**

- Court assessed \$21.8 million in damages for losses caused by the “improper” transfer of assets that generated greater revenue sharing;
- Court also found that Plan suffered losses of \$13.4 million as a result of ABB’s failure to monitor recordkeeping costs and to negotiate for rebates;
- All defendants (ABB, its Pension Review Committee, Pension and Thrift Management Group, the Director of that Group and its Employee Benefits Committee) held jointly and severally liable for these amounts.

The Solution

- **Examine whether fees paid to service providers and other expenses of the plan are “reasonable”**
 - Avoids potential fiduciary liability and prohibited transaction exposure for failure to examine this issue.
 - Protects ERISA section 404(c) safe harbor (which insulates an employer from ERISA fiduciary liability) that may be negated by failure to identify and disclose all plan fees and expenses to plan participants.
- **Such a review can “recapture” significant assets for the benefit of both the employer and plan participants.**

The Solution

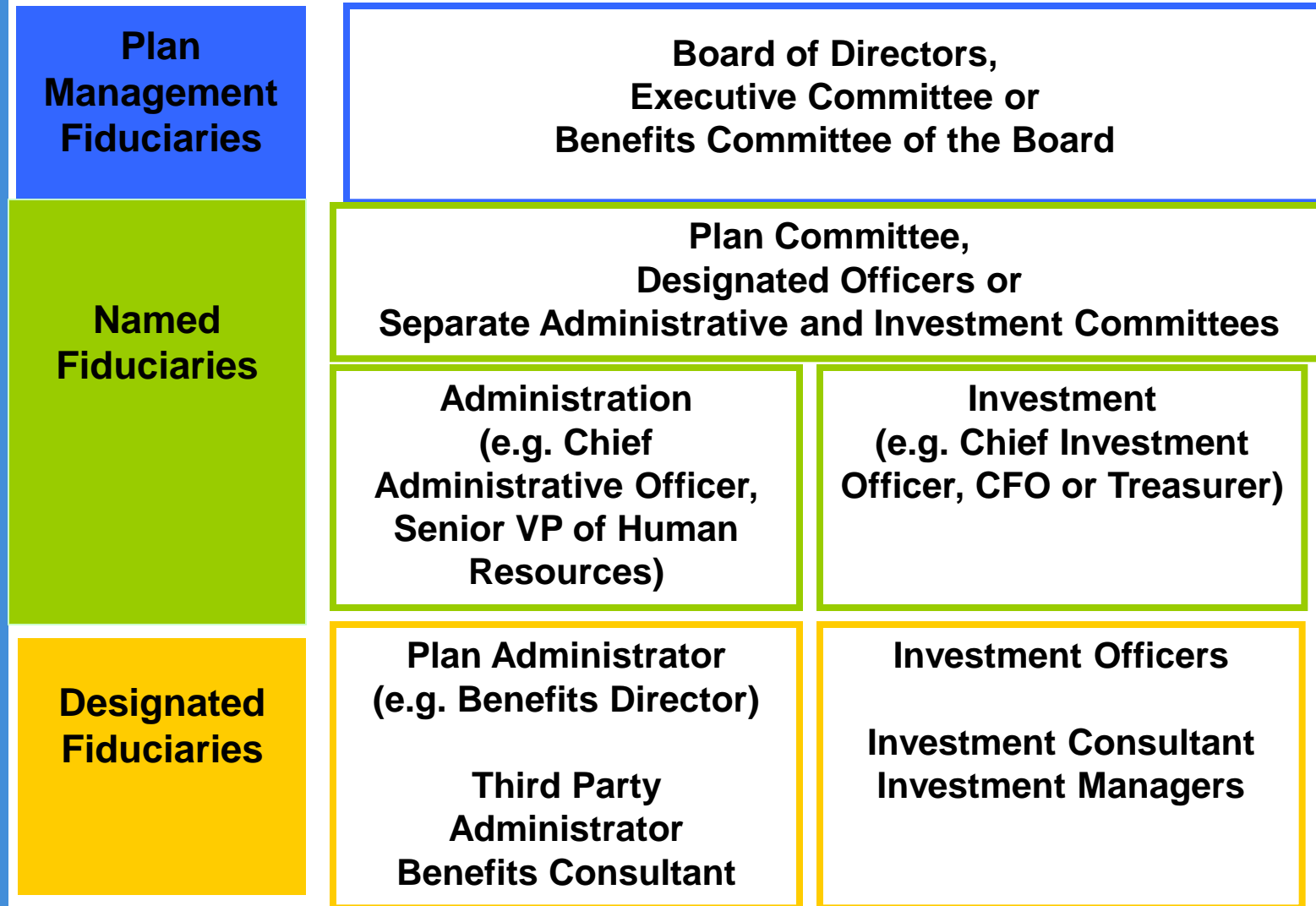
- **“Reasonableness of fees” not easily ascertained**
 - ❑ Traditional investment consulting firms may not be able to perform forensic investigation and provide negotiation necessary to uncover embedded and undisclosed fees.
 - ❑ Independent counsel who specializes in this area can provide analysis on confidential basis.
 - ❑ Helps to avoid participant and government litigation for excess fees that may come to light as the result of the forensic plan expense review process.

Best Practice Governance

- **Establish “Best Practice” Governance Procedures to Limit Liability of Board of Directors and Senior Executives**
- **Best Practice Governance is Implementing a**

PRUDENT PROCESS and
TRANSPARENCY CONTROLS
for Effective Governance of the Plan

Best Practice Process



Best Practice Governance

Board of Directors is responsible for:

- **Establishing or amending the plan**
- **The selection and retention of the named fiduciary through establishment or amendment of the plan**
- **Naming a plan administrator**

Best Practice Process

The Named Fiduciary for Investments:

- **Adopt a Statement of Investment Policies**
- **At least annually review the performance of the trustee and report to the Board**
- **At least quarterly review and evaluate the investment results of each of the investment managers and report (at least annually) to the Board of Directors**
- **Obtain from each investment manager its certification of compliance with the Statement of Investment Policies and other prudence and transparency requirements**

Best Practice Process

The Named Fiduciary For Administration:

- **Establish a manual containing plan administration objectives and procedures and codification of plan interpretation**
- **Identify and delegate (e.g. Human Resources, Controller, General Counsel) areas of responsibility with respect to plan administration**
- **Submit a report (at least annually) to the Board with respect to plan administration and compliance**

Best Practice Process

The Named Fiduciary should:

- **At least annually review the performance of any fiduciaries designated by such named fiduciary and persons employed to render advice**

The Designated Fiduciary should:

- **Review the performance of any person it has employed to render advice**
- **This review should be performed at reasonable intervals to ensure that it has no reason to doubt the competence, integrity or responsibility of such person**