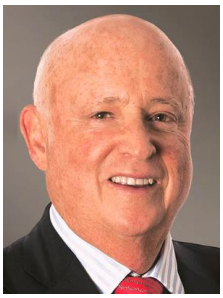
Now More Than Ever, Fiduciaries Must Revisit ERISA Origins

By **Jeff Mamorsky** (May 24, 2023)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With growing concerns about the volatility of today's investment environment, legislation both promoting and impeding environmental, social and governance considerations in investing, and other political pressures, public plan fiduciaries must understand the importance of the Employee Retirement Income Security Act's robust fiduciary provisions.

In particular, the U.S. Department of Labor's issuance of regulations on considering ESG factors,[1] in addition to satisfying ERISA's duty of loyalty to act for the exclusive benefit of plan participants,[2] has put plan fiduciaries in a difficult position.

An examination of ERISA's foundations and historical perspective is now more important than ever.

This examination is particularly important in view of recent U.S. Supreme Court decisions, like 2015's Tibble v. Edison International,[3] which required a duty to monitor investments by plan fiduciaries, and 2022's Hughes v. Northwestern University,[4] which held that every investment option on the menu must be prudent.

Historical Perspective

ERISA was enacted as the result of congressional hearings on the so-called broken pension promise in the late 1960s, relating to the bankruptcy of the carmaker Studebaker Corp. and other numerous plant closings that left thousands of employees dismissed with no pension.

ERISA for the first time provided vesting for retirement benefits after the completion of years of service rather than the attainment of age 65, along with a panoply of protections such as fiduciary prudence and conflicts-of-interest rules in order to safeguard the rights of plan participants.

It was truly landmark legislation that has stood the test of time.

During the creation of ERISA from 1972-1974, I was fortunate to be counsel to a Business Roundtable Task Force that participated in the ERISA drafting process, particularly with respect to its fiduciary provisions.

That task force, which became the ERISA Industry Committee after ERISA's enactment, also worked with the DOL in drafting fiduciary regulations as to how to implement ERISA's provisions.

Shortly after the issuance of the DOL regulations, the task force prepared Proposed Guidelines for Review of Fiduciary Performance for Business Roundtable member companies on the procedures necessary to comply with ERISA.

This has become a road map for plan sponsors that want to be prudent fiduciaries.

ERISA only regulates employer-sponsored retirement plans in the private sector, and

generally does not apply to public plans. However, since its enactment, 70% of U.S. states have voluntarily adopted ERISA's fiduciary standard of care, defined in ERISA Section 404(a)(1)(B), which requires fiduciaries to discharge their 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.

The significance of ERISA's fiduciary standard of care is the addition of the phrase "familiar with such matters" to the English common law definition. It has resulted in the development of a judicial ERISA prudent expert rule that has helped safeguard the rights of plan participants.

Twenty-seven states[5] and Washington, D.C., have adopted verbatim ERISA's fiduciary standard of care to govern the conduct of trustees responsible for the investment and management of assets held by the defined benefit plans in their statewide public employee retirement systems.

Kentucky, New Hampshire, South Carolina and Wyoming have adopted the fiduciary standard of care contained in the Uniform Management of Public Employee Retirement Systems Act, which is nearly identical in wording to that of ERISA's standard.

In addition, Kansas, North Carolina, Oregon and Pennsylvania have each selected portions of ERISA's fiduciary standard of care and incorporated them into their own fiduciary standard.

Also, ERISA's standard of care and supplemental fiduciary duties of prudence have had a similar substantial influence on county, municipal and other public employee retirement systems. This is a testament to the enormous influence that ERISA's fiduciary provisions have had on public employee retirement systems in the U.S.[6]

In view of the adoption of ERISA's fiduciary standard of care by 70% of the states and other public retirement systems, it is imperative that public plan sponsors, trustees and other plan fiduciaries comply with the guidance contained in the Supreme Court decisions that fiduciaries have an ongoing duty to monitor plan investments and that every investment option on the plan menu must be prudent.

These requirements, coupled with ERISA's duty of undivided loyalty to act exclusively for the benefit of plan participants and make decisions as a prudent expert who is familiar with such matters,[7] put an enormous burden and potential liability on plan fiduciaries.

Fortunately, ERISA was drafted with important provisions that enable plan sponsors and their fiduciaries to limit their liability by the allocation and delegation of fiduciary responsibility.

These statutory provisions of ERISA, enacted into law in September 1974, are described below; along with the DOL Fiduciary Regulations 2509.75-5 and 2509.75-8, adopted in July and October 1975, respectively, and discussing the allocation and delegation of fiduciary responsibility; and the Proposed Guidelines for Review of Fiduciary Performance, which was prepared November 1975.

ERISA Definition of "Named Fiduciary," and Allocation and Delegation of Fiduciary Responsibility

The ERISA provision that allows named fiduciaries to allocate and delegate fiduciary responsibility is contained in Section 405(c), which allows a plan to provide for procedures for allocating fiduciary responsibilities and for named fiduciaries to designate other persons to carry out fiduciary responsibilities.

As a result of the implementation of this allocation and delegation procedure, the named fiduciary is not liable for an act or omission of persons in carrying out their allocated or delegated responsibilities.

Limiting liability through an allocation and delegation process is important since ERISA Section 402(a) requires a plan to provide for a named fiduciary to control and manage the operation and administration of the plan.

Without the ERISA Section 405(c) allocation and delegation provision, named fiduciaries face enormous potential liability. With the provision, if properly drafted and implemented, named fiduciaries are only responsible for the monitoring of performance of each fiduciary it has designated.

Finally, it is important to emphasize that the ERISA Section 3(21) definition of fiduciary is very comprehensive and includes not only a named fiduciary but also a person who

> (A) exercises discretionary authority or control over plan management of such plan or exercises any authority or control respecting management or disposition of its assets, (B) renders investment advice for a fee ... or has [the] authority or responsibility to do so, or (C) has any discretionary authority or discretionary responsibility in the administration of [the] plan.

DOL Regulations

As a result of meetings between the DOL and Business Roundtable Task Force shortly after the enactment of ERISA, the DOL issued fiduciary regulations addressing the ability to limit fiduciary liability with an allocation and delegation procedure, provided that the performance of designated fiduciaries are reviewed at reasonable intervals.

For example, the regulations provide that if the plan has and implements an allocation and delegation procedure, named fiduciaries are not liable for the acts and omissions of a person who it has designated.[8]

However, the regulations emphasize that at reasonable intervals, the performance of the designated persons must be evaluated by the appointing fiduciary to ensure that their performance has been in compliance with ERISA and the terms of the plan.[9]

Finally, it is important to emphasize that the DOL regulations provide that members of the board of directors — or trustees in the case of a governmental entity or not-for-profit — of an employer that maintains an employee benefit plan will be fiduciaries only to the extent that they have responsibility for the functions described in Section 3(21) of ERISA.

For example, if the board is responsible for the selection and retention of plan fiduciaries, their responsibility — and consequently, their liability — is limited to the selection and retention of fiduciaries.[10]

Proposed Guidelines for Review of Fiduciary Performance

In view of the importance of the review process in limiting plan sponsor liability, the Business Roundtable asked its task force to prepare Proposed Guidelines for Review of Fiduciary Performance.

Set forth below is a discussion of how the board and named fiduciaries can use the proposed guidelines to implement best practices that can help limit liability.

ERISA-Required Board Actions

The board should designate a named fiduciary in the plan document or in accordance with the procedure set forth in the plan.

In so doing, the board must assure itself and receive evidence that each designated person has the qualifications necessary to fill the position.

In the event the named fiduciary is a committee, the members of the committee, as a group, should have the qualifications necessary to fill the position.

Also, the board has an ongoing responsibility to review the performance of the named fiduciary at reasonable intervals to ensure that its performance has been in compliance with its duties under ERISA.

ERISA-Required Named Fiduciary Actions

A named fiduciary should appoint designated fiduciaries to limit its liability. In so doing, including by appointing an investment manager or in employing a person to render advice, the named fiduciary must make sure that each person being appointed, designated or employed has the qualifications, and receive evidence that such person has the qualifications requisite for service in such position.

It is essential that the named fiduciaries review, at reasonable intervals, the performance of each fiduciary it has designated, including each investment manager it has appointed, to make sure that such fiduciary's performance is in compliance with ERISA, and assure itself that it has no reason to doubt the competence, integrity or responsibility of such person.

Board Review of Fiduciaries Performance

The board has the duty to review the performance of the designated named fiduciary or fiduciaries, plan administrator or plan trustee.

In so doing, the board should utilize procedures or guidelines it will follow in order to fulfill its responsibilities in the review of such fiduciaries' performance, and at least annually review the performance of such fiduciaries.

Also, it is important that the board keep minutes of its meetings to demonstrate discharge of its duty to review the performance of such fiduciaries.

In its review of plan administration, the board should review the performance of each fiduciary engaged in the administration of the plan to make sure that the fiduciary is discharging, and will continue to discharge, its duties as a fiduciary under ERISA solely in the interest of participants and beneficiaries, for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable plan administration

expenses, with the prudence of someone familiar with such matters.

In its review of plan investments, the board should review the performance of each fiduciary responsible for investment of the assets of the plan to make sure that the fiduciary is discharging, and will continue to discharge, its duties as a fiduciary under ERISA, solely in the interest of participants and beneficiaries, for the exclusive purpose of providing benefits to participants and their beneficiaries and with the providence of a person familiar with such matters, by diversifying investments so as to minimize the risk of large losses and in accordance with plan document provisions not inconsistent with ERISA.

In such review, the board should examine evidence of actions taken by the fiduciary, such as a report on any investment guidelines established by the named fiduciary and on compliance with such guidelines, and a report on the investment activities and changes during the most recent reporting period.

More Important Than Ever

The historical foundations of ERISA discussed above have stood the test of time and are now more important than ever.

ERISA was created with important protections for plan fiduciaries who are judged as prudent experts under ERISA's fiduciary standard of care.

The most important protection is ERISA's allocation and delegation provision, which should be adopted and implemented in view of today's volatile environment and the Supreme Court decisions emphasizing that fiduciaries have an ongoing duty to monitor all plan investments.

This provision is the armor that provides protection in the event of litigation. If properly drafted and implemented, the plan sponsor, its trustees and plan-named fiduciary are only responsible for the monitoring of the allocated and delegated performance of each person designated.

Without the provision in place, the plan sponsor, trustees and named fiduciary face enormous potential liability.

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[1] DOL Final Rule to Remove Barriers to Considering ESG Factors in Plan Investments, Federal Register, Vol. 87, No.230, 29 CFR Part 250, RIN 1210-AC03, December 1, 2022.

[2] See ERISA § 404 (a)(1)(a) and DOL Regulation § 2550.404a-1.

[3] Tibble v. Edison, 575 U.S. 523, 5/18/2015.

[4] Hughes v. Northwestern, U.S.S.Ct. No.19-1401, 1/24/2022.

[5] Alabama, Alaska, Arizona, California, Colorado, Connecticut, Delaware, Florida, Idaho, Illinois, Indiana, Louisiana, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Montana, Nebraska, New Jersey, New York, Ohio, Oklahoma, Rhode Island, Virginia, Washington and Wisconsin.

[6] See https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4287238.

[7] ERISA Section 404 (a)(1)(b)).

[8] Q&A FR-14 of Section 2509.75-8.

[9] Q&A FR-17 of Section 2509.75-8.

[10] Q&A D-4 of Section 2509.75-8.