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Prepared by The Wagner Law Group

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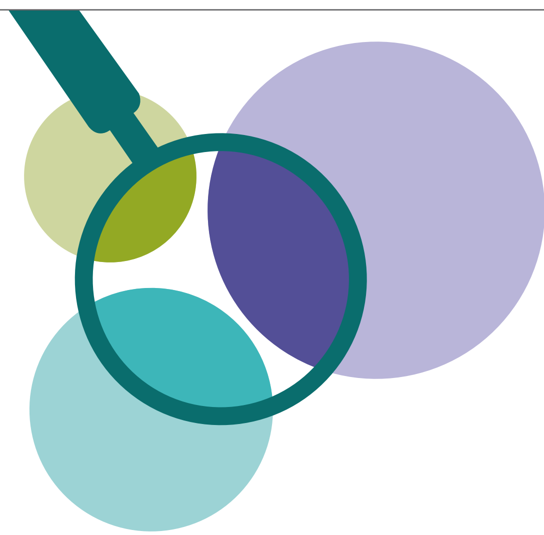


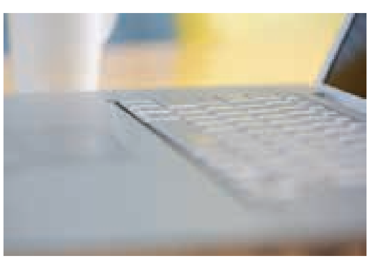
Clearing up misconceptions about fiduciary risk and plan investments.

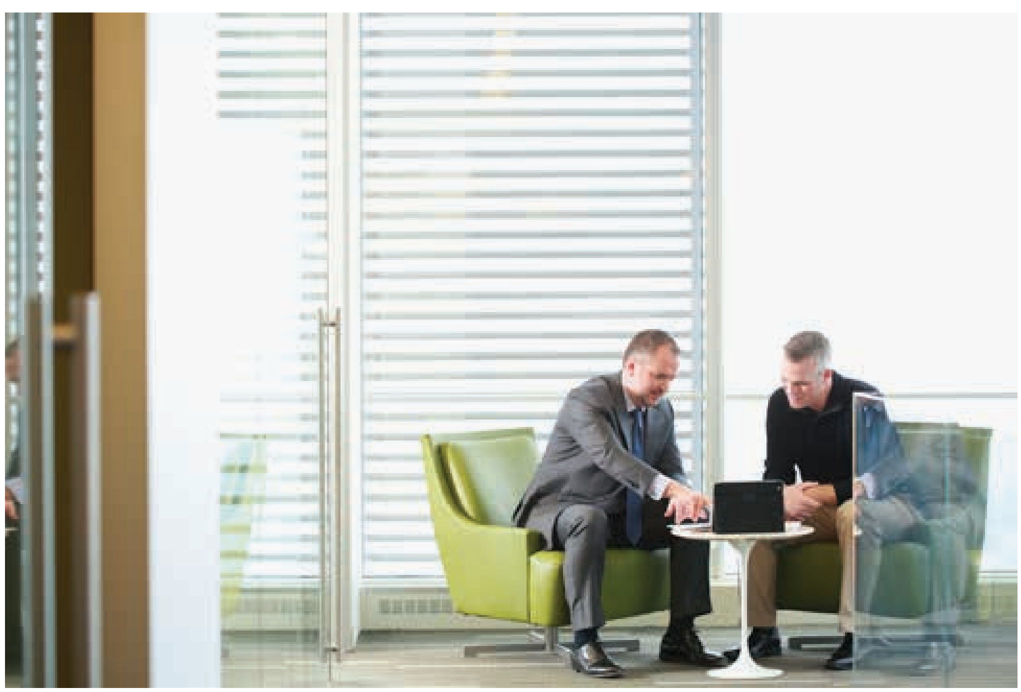
INTRODUCTION

Misconceptions about plan sponsor's duty to monitor

Because of the large amount of work required to establish a defined contribution retirement plan, plan sponsors may mistakenly feel that their job is finished once the plan is up and running. In actuality, plan sponsors have a duty to proactively monitor the plan's investments on an ongoing basis, and they should be mindful of the fiduciary risks associated with mishandling the plan's investments. The rules governing a fiduciary's ongoing duties are not always intuitive, which can lead to misconceptions about a plan sponsor's continuing obligations to the plan and its participants. While similar fiduciary duties apply to defined benefit plans, this white paper focuses on particular issues related to participant-directed defined contribution plans.

These misconceptions may even cause a plan sponsor to grow complacent enough to neglect the fiduciary maintenance work that is required. The reality is that a failure to properly manage the plan's investments can be a costly mistake. The courts in many instances have held plan sponsors accountable for their actions or, to be more precise, their lack of action. The good news is that we can draw valuable lessons from these court cases, and they can help clear up various misconceptions about fiduciary risk and the investment duties imposed on plan sponsors.





MISCONCEPTION NUMBER 1

No litigation risk

"Our plan participants would never sue me."

When times are good, people may find it difficult to imagine relationships breaking down to the point where lawsuits are filed against one another. Similarly, employers that go to the trouble of establishing a 401(k) plan may find it hard to envision plan participants turning on them one day and suing them. However, as a practical matter, employees and plan participants do not always remain on good terms with their employer. In addition, if a participant suffers a heavy financial loss that could potentially be related to the employer's mismanagement of the plan, the participant may feel that he or she has no choice but to move forward with a legal claim against the plan sponsor.

The federal law that governs legal claims against plan sponsors and other fiduciaries is known as the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). ERISA litigation and the related case law involving defined contribution plans have grown considerably in recent years. One possible explanation is *LaRue v. DeWolff*, a 2008 Supreme Court decision that definitively ruled that individual participants may recover from their employer or other plan fiduciaries when their plan accounts suffer a loss caused by a fiduciary breach.[1] Another likely factor is the success with which plaintiffs' attorneys[2] have been able to use class action lawsuits[3] to file ERISA claims on behalf of all similarly harmed participants under a single plan.

As a result of the successful track record for plaintiffs' attorneys and the related exposure in the media, many participants now understand that they have recourse under the law if the plan or its investments are ever mismanaged. Note, however, the successful track record for plaintiffs' attorneys has been largely achieved through settlement, rather than actual outcomes. Plan sponsors should be mindful of this development, and they should not blindly assume that their participants will never file a legal claim against them. While no plan is too small to be sued, there is less likelihood that a small plan will be sued, because of the smaller attorneys' fees that may be received. Instead, they should consider implementing prudent review procedures as further described in Exhibit A.

1 *LaRue v. DeWolff*, Boberg & Associates, Inc., 552 U.S. 248 (2008).

2 Plaintiffs' attorneys specialize in representing individuals who claim that they have been harmed by other parties. They may be willing to represent such individuals for contingency fees that are payable only if the case is won.

3 See, e.g., *Spano v. The Boeing Co.*, No. 13-8026, (7th Cir. November 29, 2013).

MISCONCEPTION NUMBER 2

No investment oversight required

"We don't need to revisit the plan's investments."

Plan sponsors have a fiduciary duty under ERISA to prudently select the investments that are to be offered to their participants, and to monitor these investment options on an ongoing basis.[4] In general, these monitoring duties require plan sponsors to review the plan's investments regularly and to replace investment options as necessary. But the reality is that certain plan fiduciaries may not fully appreciate the importance of their monitoring duties, and they may not prioritize them. Some may even question the need to revisit the plan's investments so frequently, putting themselves at fiduciary risk by leaving the plan's investments on "autopilot."

If a plan fiduciary fails to monitor the plan's investments properly, the fiduciary becomes personally liable to the plan for any resulting losses.[5] Participants may recover from the responsible fiduciary by seeking assistance from the U.S. Department of Labor (the "DOL"). They can also recover from the plan sponsor by taking legal action. Plaintiffs' attorneys have become effective at recovering money on behalf of participants, as illustrated in the cases below. Note that courts have generally found awards of attorneys' fees in the range of 25% to 33% of the settlement amount to be reasonable.[6]

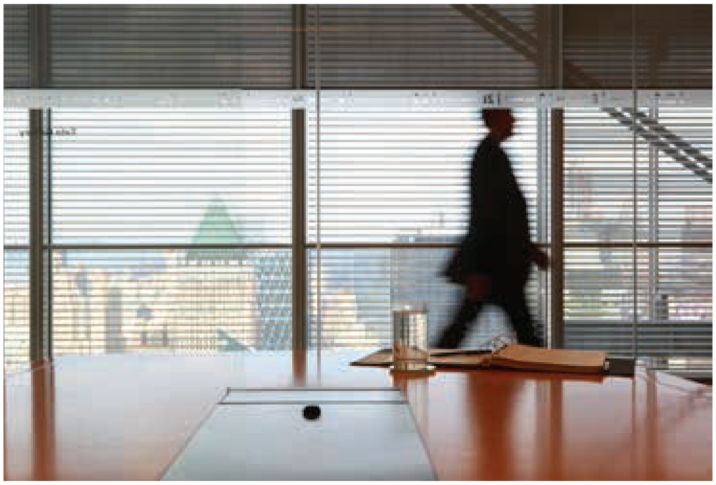
ERISA monetary settlements and awards for participants ($)

Haddock v. Nationwide Financial Services, Inc.	Abbott v. Lockheed Martin Corp.	Tussey v. ABB, Inc.	Kruger v. Novant Health, Inc.	Main v. American Airlines, Inc.	Ramsay v. Philips North America, LLC	Braden v. Wal-Mart Stores, Inc.
140.0 million	62.0 million	36.9 million	32.0 million	22.0 million	15.0 million	13.5 million

4 Section 2550.404c-1(d)(2)(iv) of the U.S. Department of Labor regulations.

5 ERISA Section 409.

6 Johnson v. Fujitsu Technology and Business of America, Inc. 2018 WL 2183253 (N.D. Cal. May 11, 2018)



In these cases, it is typically alleged that the plan sponsor failed to monitor the plan's investments properly. Additionally, the respective participants claimed that the plan sponsor had failed to monitor the reasonableness of the plan's investment fees and expenses, including the revenue sharing payments made from the plan's investment funds to the plan's recordkeeper (e.g., shareholder service fee, 12b-1 fee). Based on these and other facts, the courts made substantive and procedural rulings in favor of the participants, resulting in the monetary settlements and awards to the plan participants as described above.

To minimize fiduciary risk and potential liability, plan sponsors should consider conducting reviews of the plan's investment menu at regular intervals (e.g., quarterly). These reviews should examine investment performance as well as the reasonableness of investment fees and any revenue sharing payments that are payable to the plan's recordkeeper. A fee policy statement ("FPS") can provide easy-to-follow guidelines for evaluating such fees and expenses, and plan sponsors may use an FPS to monitor any revenue sharing payments made to the recordkeeper. If a plan sponsor needs assistance monitoring the plan's investments and the related fees or implementing a fee policy statement, it should consider consulting a qualified advisor.

Legg Mason's Guidelines for FPS

For more information about fee policy statements, be sure to ask for Legg Mason's Guidelines for Creating a Fee Policy Statement (FPS).

MISCONCEPTION NUMBER 3

Reliance on menu size

"As long as the plan offers a lot of investment options, I've done my job."

Investments by their nature have risks associated with them. In the case of 401(k) and 403(b) plans as well as other similar plans with participant-directed investments, plan sponsors may incorrectly assume that all investment responsibility resides with the participant. A plan sponsor may even believe that there is no liability risk for the plan sponsor when it comes to the plan's designated investment options, as long as the plan menu is large enough to give participants plenty of choice.

As a matter of law, plan sponsors have a duty to prudently select the plan's investment options, which means that they must screen out any unsuitable investment choices as well as discontinue any designated investment alternatives that become unsound at any point in the future. There is a "safe harbor" under ERISA Section 404(c), which protects plan fiduciaries from any liability for losses that result from the participants' exercise of control over their accounts.[6] However, the DOL's long-standing position is that the act of designating investment options for plan participants is a fiduciary function, and that Section 404(c) cannot eliminate the plan fiduciary's obligation to periodically evaluate whether the investment options should continue to be made available to participants.[7] The DOL's position was affirmed by an appellate court in *Tibble v. Edison International*, which expressly confirmed that "the selection of the particular funds to include and retain as investment options in a retirement plan is the responsibility of the plan's fiduciaries."[8]

Several recent lawsuits have in fact alleged that participants were offered too many investment elections. While these allegations have proven unsuccessful, there is evidence that offering a large number of investments is counter-productive. Rather than focusing solely on the quantity of investment options offered to participants, plan sponsors should pay attention to the quality and the diversity of the plan's available investments for participants. To ensure the plan menu covers a sufficiently diverse range of asset classes, plan sponsors should consider maintaining an investment policy statement ("IPS") and using it to guide their fiduciary review of the plan investment menu. In assessing the quality of the plan's investment options, plan fiduciaries can also use the applicable investment criteria from the IPS to help them monitor investment performance as well as investment fees and expenses. IPS guidelines can also help plan sponsors prudently determine whether and when an investment option should be replaced.

Legg Mason's Guidelines for IPS

For more information about investment policy statements, be sure to ask for Legg Mason's Guidelines for Creating an Investment Policy Statement (IPS).

[6] ERISA Section 404(c) and the related DOL regulations include various administrative and investment-related requirements. These conditions must be met in order for the safe harbor protection to become available.

[7] Preamble to DOL regulations under ERISA Section 404(c), 57 Fed. Reg. 46,906 (October 13, 1992).

[8] *Tibble v. Edison International*, No 10-56406 (9th Cir. March 21, 2013).

MISCONCEPTION NUMBER 4

Investment tips from administrative providers

"An administrative provider is responsible for its investment tips, even if it says it's not a fiduciary."

Plan sponsors often need to engage two types of administrative providers for their plans, a recordkeeper and a third party administrator ("TPA"). A recordkeeper establishes and maintains individual accounts for the plan's participants. A TPA is often required to assist with plan design, annual compliance testing and regulatory filings. Although recordkeepers and TPAs are not in the business of providing investment advice, they may offer ancillary support to plan fiduciaries when they are choosing the plan's investment options. A recordkeeper or TPA may volunteer their personal views concerning the quality of a particular investment fund. If asked, these providers may even provide informal recommendations concerning the plan's investments based on what their other plan clients are doing and other relevant information.

However, plan sponsors should not rely on any investment tips that they might receive from their administrative providers in the same way that they might rely on fiduciary investment advice. From the plan sponsor's own fiduciary perspective, it would be imprudent to trust the investment recommendations of a firm that is not formally in the business of providing such advice. Firms that provide investment-related services are subject to heavy regulation, making them accountable for their recommendations under federal and state securities laws as well as ERISA.

As of the date of this writing, the status of who is a fiduciary by virtue of rendering investment advice for a fee is in a state of flux. In 2016, the DOL issued the "Fiduciary Rule," which greatly expanded the five-part definition of fiduciary investment advice originally issued in 1975. The Fiduciary Rule included a new definition of fiduciary investment advice, as well as several new and modified prohibited transaction exemptions. Although the DOL's Fiduciary Rule was upheld by a number of District Courts, in March 2018, the Court of Appeals for the Fifth Circuit, in a 2-1 decision, invalidated "in toto" the entire Fiduciary Rule including the related prohibited transaction exemptions. In response, the DOL issued temporary enforcement guidance in which it announced that it will not pursue prohibited transaction claims against investment advice fiduciaries working diligently and in good faith to comply with the invalidated prohibited transaction exemptions. Now that the Fiduciary Rule has been invalidated, the previous five-part definition once again applies and depending on the facts and circumstances, an advisor who was a fiduciary under the Fiduciary Rule may no longer be a fiduciary under the five-part test.

Furthermore, the SEC has also initiated regulatory efforts to heighten the standard of care advisors owe. On April 18, 2018 the SEC issued a detailed set of proposed rules that creates a "best interest" standard when making a recommendation as to investment strategy but it is not as expansive as the DOL's Fiduciary Rule. Comments to the SEC's proposed rule which were due by August 7, 2018 totaled over 3,800. Thus, uncertainty continues until the final SEC rules are issued.

As was the case prior to the issuance of the Fiduciary Rule, if a provider is not a fiduciary under the five-part test, then it is not responsible or subject to liability for any imprudent investment recommendations. In fact, to minimize their exposure to any potential fiduciary liability, it is customary for administrative providers to include disclaimers in their service agreements, stating that they are not fiduciaries or that their services do not include any fiduciary advice. Of course, a provider that is not appointed to serve as a fiduciary can still be deemed a "functional" investment fiduciary under the five-part test, but only if it regularly provides individualized investment recommendations under a mutual understanding that the plan will be relying on such advice.[9] However, as noted in *Mortgage Lenders Network USA v. CoreSource*, a contractual disclaimer is still relevant for purposes of determining a provider's fiduciary/non-fiduciary status, even if it is not conclusive evidence of its status.[10]

If a plan sponsor tries to hold an administrative provider accountable for any investment advice, the provider would presumably assert that it was not a functional fiduciary under the five-part test because (i) it does not regularly provide investment recommendations, (ii) its recommendations are generic and are not individualized to particular plans, (iii) there is no mutual understanding that it would be providing fiduciary advice, and (iv) assuming that its service agreement has the customary language, a contractual disclaimer confirms that it does not serve as a fiduciary. Plan sponsors should not automatically rely on the provider's investment recommendations but should independently evaluate a provider's recommendations, and only follow them if they are able to reach the same conclusions **prudently** based on their own investment analyses.

MISCONCEPTION NUMBER 5

Investment role of recordkeeper

"Our recordkeeper takes care of everything, including the plan menu."

In addition to maintaining individual participant accounts, the plan's recordkeeper customarily also provides an investment platform. This platform gives the plan and its participants the ability to access a universe of investment funds. Accordingly, the investment options to be offered to the plan's participants will be selected from the investment funds that are made available on the recordkeeper's platform. In many programs, the recordkeeper will determine the specific share class of the investment funds that are made available to its plan clients. Furthermore, since the recordkeeper may make changes to its fund universe from time to time, the recordkeeper typically reserves the right to add or remove investment options from a plan client's investment menu for the purpose of making corresponding changes. Once the plan sponsor designates the investment options that are to be offered, the recordkeeper generally implements the offering to participants and provides any necessary investment disclosures to them.

Because of the critical role that the recordkeeper plays in the operation of the plan's investment menu, plan sponsors may assume that the recordkeeper is acting as an investment fiduciary. However, given the limited scope of a traditional recordkeeper's investment role, plan sponsors should not automatically make this assumption. For example, in *Leimkuehler v. American United Life Insurance Co.*, the court ruled that a recordkeeper's "product design" decisions, which determined the universe of funds available to the plan as well as their share class, did not turn the recordkeeper into a fiduciary.[11]

Although recordkeepers play a vital role in the implementation of the plan's investment menu, plan sponsors should not view them as advisors when it comes to the management of the investment menu. Plan sponsors should consider engaging a separate provider, such as a qualified financial advisor, to help them select and monitor the plan's investment options. An

[9] See, e.g., *Thomas, Head & Greisen Employees Trust v. Buster*, 24 F.3d 1114 (7th Cir.), cert. denied, 115 S.Ct. 935 (1994). The courts have generally adopted the functional definition for fiduciary "investment advice" under Section 2510.3-21 of the DOL regulations.

[10] *Mortgage Lenders Network USA v. CoreSource*, 335 F. Supp. 2d 313, 319-323 (D. Conn. 2004).

[11] *Leimkuehler v. American United Life Insurance Co.*, 713 F.3d 905 (7th Cir. 2013). It should be noted that the case law in this area is mixed, and it is possible for a court to rule that a particular recordkeeper should be held accountable as a functional fiduciary based on the particular facts of the case. However, it would not be prudent for plan sponsors to automatically assume that the court will rule in their favor.

advisor can provide helpful guidance concerning the selected funds as well as the other investments available from the recordkeeper's fund universe. Additionally, if a recordkeeper's program requires the plan menu to include one or more funds pre-selected by the recordkeeper, the advisor can provide an independent assessment of the prudence of utilizing such funds. Consistent with their duty to monitor the plan's investments on an ongoing basis, plan sponsors should also consider meeting with the advisor regularly (e.g., quarterly) to assist with the reviews of each of the plan's investment options. Any recommendations made by the advisor should be considered by the plan sponsor in light of the advisor's investment expertise and experience as well as the advisor's status as a fiduciary or non-fiduciary to the plan.

MISCONCEPTION NUMBER 6

Free Recordkeeping

"A plan satisfies its fiduciary responsibility for managing recordkeeping fees if it receives recordkeeping services for free."

This misconception may be less prevalent than it was before DOL fee disclosure regulations[15] required a detailed breakdown of both direct and indirect compensation, but plan sponsors should be particularly cautious when a recordkeeper claims that it doesn't charge any recordkeeping fees. Recordkeepers do not provide recordkeeping services to a plan "free of charge" as there are considerable costs associated with 401(k) plan administration such as recordkeeping software, computer infrastructure, as well as staff. Plan sponsors are advised to actually read the fee disclosures provided by the recordkeeper. While it is true that a recordkeeper's compensation may not be in the form of direct payments from a plan or plan sponsor, it may, however, receive compensation by means of indirect payments, such as revenue sharing from a third party, including a mutual fund. The arrangements under which these indirect payments are made to a recordkeeper are referred to as revenue sharing arrangements.

Although revenue sharing arrangements are frequently challenged in 401(k) plan litigation under ERISA, ERISA does not prohibit them. Their use in recent years has declined but there are a number of ways in which revenue sharing arrangements can be addressed under a plan. However, from a plan fiduciary's perspective both the DOL[16] and courts[17] take the position that if a plan service provider, such as a recordkeeper, receives revenue sharing payments attributable to a plan's investment in a fund, then the plan service provider's compensation for plan-related services includes those revenue sharing payments, and must be reasonable in light of the services provided.

[15] Section 2550.408b-2 of the U.S. Department of Labor regulations.

[16] DOL Advisory Opinion 2013-03A.

[17] See, e.g., *Tussey v. ABB, Inc.*, 746 F. 3d 327 (8th Cir. 2014).

CONCLUSIONS

It is important for plan sponsors to have an accurate understanding of their continuing obligations to their respective plans and participants, and to avoid misconceptions about their duties as plan fiduciaries.

The relevant case law under ERISA provides valuable guidance on the true nature of fiduciary risk and the importance of monitoring the plan's investments regularly. Plan sponsors should not assume that they are immune from fiduciary liability.

Accordingly, they should consider conducting reviews of the plan's investment menu on a regular basis (e.g., quarterly), and using an FPS to evaluate investment fees as well as any revenue sharing payments made to the plan's recordkeeper. Rather than focusing solely on the quantity of investment options, plan sponsors should evaluate the quality and diversity of the plan's investment options using an IPS. If an administrative provider offers any investment tips, plan sponsors should independently evaluate them and not automatically rely on them. Lastly, plan sponsors should consider engaging a qualified advisor to help them monitor the plan's investments on an ongoing basis.

We have attached a Plan Sponsor Self-Assessment and Checklist (Exhibit A), which provides a brief summary of the various misconceptions and related court cases discussed in this paper. This checklist can be used by plan sponsors to perform their own fiduciary assessment and to help them determine whether any corrective action should be taken.

EXHIBIT A

Plan sponsor self-assessment and checklist		
Fiduciary misconceptions	**Actual ERISA case law**	**Suggested corrective actions**
1 No litigation risk "Our plan participants would never sue me."	LaRue v. DeWolff This Supreme Court case confirms that a participant who suffers a loss due to plan mismanagement is entitled to recover from the responsible plan fiduciary.	Acknowledge that participants have recourse under the law if the plan or its investments are mismanaged, and implement prudent review procedures. ☐ This practice is already in place. ☐ Further action/review is required.
2 No investment oversight required "We don't need to revisit the plan's investments."	Tussey v. ABB, Inc. In this case and others like it, the court ruled that a plan sponsor is responsible for monitoring the plan's investment funds and the related fees and expenses, including any revenue sharing paid from the funds to the recordkeeper.	Monitor the performance and fees of the plan's investments regularly (e.g., quarterly), and use a fee policy statement to evaluate any revenue sharing payable to the plan's recordkeeper. ☐ This practice is already in place. ☐ Further action/review is required.
3 Reliance on menu size "As long as the plan offers a lot of investment options, I've done my job."	Tibble v. Edison International This case confirmed that the plan sponsor is responsible for the prudent selection and retention of each investment option under the plan.	Use an investment policy statement to prudently evaluate the quality and diversity of the particular investment options offered to participants. ☐ This practice is already in place. ☐ Further action/review is required.
4 Investment tips from administrative providers "An administrative provider is responsible for its investment tips, even if it says it's not a fiduciary."	Mortgage Lenders Network USA v. CoreSource According to the court, a contractual disclaimer stating that the administrative provider is not a fiduciary is relevant in determining the provider's status (even if it is not conclusive evidence of status).	Does the administrative provider's agreement state that it is not a fiduciary? If so, independently evaluate the provider's investment recommendations and do not automatically rely on them. ☐ This practice is already in place. ☐ Further action/review is required.
5 Investment role of recordkeeper "Our recordkeeper takes care of everything, including the plan menu."	Leimkuehler v. American United Life Insurance Company This case held that a recordkeeper's "product design" decisions, which may determine the universe of funds available to the plan as well as their share class, do not turn the recordkeeper into a fiduciary.	Rely on the recordkeeper for administrative assistance only, and meet with a qualified financial advisor regularly (e.g., quarterly) to assist with the monitoring of the plan's investments. ☐ This practice is already in place. ☐ Further action/review is required.
6 Free Recordkeeping "A plan satisfies its fiduciary responsibility for managing recordkeeping fees if it receives recordkeeping services for free."	George v. Kraft Foods Global, Inc. This case held that a trier of fact could reasonably conclude that the plan did not satisfy its duty to ensure that the recordkeeper's fees were reasonable.	Plan sponsors must read the fee disclosures provided by the recordkeeper and seek advice of counsel if necessary. ☐ This practice is already in place. ☐ Further action/review is required.

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About Marcia Wagner and The Wagner Law Group

Marcia Wagner is the founder of The Wagner Law Group, one of the nation's largest and most highly regarded law firms specializing in ERISA, employee benefits and executive compensation, and has practiced employee benefits law for over 30 years.

She is an authority on qualified and non-qualified plans, fiduciary issues, deferred compensation, and welfare benefit arrangements, with experience in plan design and drafting, compliance, tax planning and consultation on all aspects of ERISA and the Internal Revenue Code. Ms. Wagner also serves as an expert witness in ERISA litigation.

Ms. Wagner specializes in Title I of ERISA, and has obtained advisory opinions, information letters and prohibited transaction exemptions from the DOL. She handles fiduciary matters impacting plan sponsors, investment and other fiduciary committees, investment managers and advisors, recordkeepers, broker-dealers, banks, and other financial services firms. Ms. Wagner advises clients on the avoidance and rectification of prohibited transactions, the development of compliance programs, and investment policies. She is a renowned expert in issues concerning pension plan investments and fiduciary issues, and her opinion has been sought by noted authorities in the employee benefits area, including governmental agencies.

She was appointed Chair of the Employee Plans subcommittee of the IRS Tax Exempt & Government Entities Advisory Committee and received that agency's highest honor. She is a Fellow of the American College of Employee Benefits Counsel and is the recipient of more than 50 professional honors.

Ms. Wagner has written hundreds of articles and 15 books. She is a highly sought after lecturer, is widely quoted in financial journals and has been a guest on Fox, CNN, Bloomberg, and NBC.

* As of June 30, 2018.

All investments involve risk, including loss of principal.