Delaware OST
FIDUCIARY DUTIES

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PRESENTED BY

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Agenda

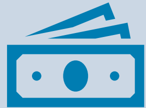
- Fiduciary Basics
- Fiduciary Duties in Connection with Funding/Investments
- Overview of Litigation
- Best Practices for Mitigating Liability
- Other Topics to Watch
- Small Balance Cash Outs and Escheatment

Fiduciary Basics

Board’s Role as Fiduciary

- Settlor establishes the terms of the trust and the plan in statutes:
  - The Settlor = State/General Assembly
- The Plans Management Board is administrator of the State’s Deferred Compensation Program (DC Program: 457(b) Plan, 403(b) Plan, and 401(a) Match Plan), College Investment Plan (529 Plan), and Achieving a Better Life Experience Program (ABLE Plan) (collectively, “the Plans”). 29 Del. C. § 2722; *see also* Plans’ documents.
- The term “fiduciary” includes any “trustee” and “agents to the extent delegated duties by another fiduciary.” 12 Del. C. § 3301(d).

Who is a Fiduciary?



For the Plans, fiduciaries include the members of the Plans Management Board:

- Approving investment options
- Approving annual budget for the Plans
- Performing annual audits.

Other fiduciaries may, depending on circumstances, include Investment Advisors/Consultants

Fiduciary Defined

- Look to function and designation
- Function: Discretionary administrative or investment decisions related to the plan
- Designation: Named in a plan, trust document, or statute as a fiduciary
- Trustees – both by function and designation
    - Internal Revenue Code § 4975(e)(3); ERISA § 3(21)

Sources of Fiduciary Duties

Fiduciaries are held to extremely high standards of conduct under the law.

Federal Law

- **Internal Revenue Code**
- **ERISA** *(not directly applicable, but excellent resource)*

State Law

- **Statutory Fiduciary Rules**
- **State Constitution**

Common Law

- **Restatement (Third) of Trusts** *(collection of common law)*
- **Uniform Management of Public Employee Retirement Systems Act (UMPERSA)** *(even if not adopted by State - excellent resource)*

Plan and Plan-Related Documents

- **Plan Documents**
- **Statutes**
- **Administrative Code**
- **Trust Documents**
- **Board Policies and Resolutions**
- **Governance Manual**

Affirmative Fiduciary Duties

- All powers held as a trustee – express and implied – are held in a fiduciary capacity.
- Every power or duty given to a trustee under state law must be exercised in accordance with fiduciary principles.

Affirmative Fiduciary Duty: Duty of Loyalty

Duty to act impartially among differing interests

Duty to act solely in the interest of participants and beneficiaries

Duty to act independently and without conflicts of interest

Duty to act for the exclusive purpose of providing benefits or paying reasonable plan expenses

Affirmative Fiduciary Duty: Duty of Prudence

Duty to diversify investments

Duty to act with the care, skill, prudence, and diligence of a prudent person familiar with like matters

Duty to act for the exclusive purpose of providing benefits or paying reasonable plan expenses

Duty to delegate responsibilities outside of experience

Affirmative Duty to Follow Plan Document

Fiduciary duty to administer a plan in good faith in accordance with its written terms – "by the book."

- Plan includes the statutes, administrative rules, and administrative procedures/policies
- Consistent interpretation and administration
- Timely update for legally required changes
- Timely correct plan errors

Burden on fiduciary to understand the governing documents of the plans and the context in which the plans exist. *Particularly important given the complexity of the trustees/members respective roles.

Fiduciary Duties in Connection with Funding/Investments

1. Duty of Loyalty

Duty of Loyalty: Exclusive Benefit Rule

"Under the trust instrument it [must be] impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the ***exclusive benefit of his employees or their beneficiaries***."

- Code § 401(a)(2); see also Treas. Reg. § 1.403(b)-8(d)(2)(iii); Code § 457(g)(1)
- Code Sections 401(a), 403(b) and 457(b) each contain an "**exclusive benefit rule**"
- Delaware Code § 2722(d) sets out the standard of care of the Plans Management Board and incorporates the duty of loyalty: "**The Board, its subcommittees, and each of their members shall discharge their duties with respect to each Plan solely in the interest of the participants and beneficiaries of such Plan**. . ."
- State Employees', Officers' and Officials' Code of Conduct – 29 Del. Code Ch. 58

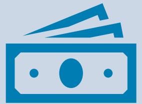
IRC DC Plans Exclusive Benefit Rule v. 529 and ABLE Plans

- Governed by Different IRC Sections
  - Not governed by same Code Sections
  - Common law of trusts
- Expressly Allowed by Statute
  - 29 Del. Code § 2722(d)(2): Allows use of administrative fees to defray reasonable plan expenses from 529 and ABLE Plans.
- Expressly Allowed by Trust
  - Permits establishment of "Administrative Fund" to pay reasonable expenses and fees, including salary, marketing, and other administrative expenses
- Consistent with Other 529 Plans
  - Different legal landscape

Exclusive Benefit Rule *(cont'd)*

Plan	Code Section
401(a) Match Plan	It must be "impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries. . . ." Code § 401(a)(2)
403(b) Plan	A custodial account under a 403(b) plan cannot be used for, or diverted to, purposes other than the exclusive benefit of the participant. Treas. Reg. § 1.403(b)-7(d).
457(b) Plan	Assets of a governmental 457(b) plan must be held in a trust for the exclusive benefit of the participants and beneficiaries. Treas. Reg. § 1.457-8(1).
529/529A Plans	Provides that the Board and subcommittees discharge duties in accordance with trust and applicable law. Establishes the prudent person standard and "authorizes the use of administrative fees from the Plan and Program to defray reasonable expenses of administering each Plan and Program, including marketing expenses, and to fund scholarship, match, or promotional programs as the Board, in its discretion, may establish. " 29 Del. Code § 2722(d)(2).

Exclusive Benefit Rule – Practical Impact for Board Members



Plan assets may only be used to pay benefits and reasonable expenses of administration in accordance with the Allocation and Payment of Plan Expenses Policy

Benefits must be payable only in accordance with plan terms

Use settlor v. fiduciary function analysis for reasonable expenses

Duty of Loyalty: Independence

A trustee is to be independent of preconceived notions

- "Many forms of conduct permissible in a workday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace." - *Meinhard v. Salmon, 164 NE 545, 546 (NY Ct. App. 1928)*
- "Independence is required because it permits trustees to perform their duties in the face of pressure from others who may not be subject to such obligations." - *UMPERSA Comments on § 5*

Duty of Loyalty: Independence *(cont'd)*

Delaware Code Chapter 58 sets forth the laws regulating the conduct of Officers and Employees of the State.

The Board must arrange for an annual financial audit of each of the Plans, to be provided annually to the General Assembly. 29 Del. C. § 2722(e)(7).

Stegemeier v. Magness, 728 A. 2d. 557 (Del. 1999) (Absolute prohibition on self dealing by Trustee)

Duty of Loyalty: Impartiality

A fiduciary owes a duty of loyalty to all participants and beneficiaries, and respecting that duty requires the fiduciary to be impartial among differing interests

Prevents application of assets for personal use, self-dealing, competition with trust, or improper benefit

Duty of Loyalty: Impartiality *(cont'd)*

- Balance the interests of retirees and active participants
- Balance the interests of different groups of participants
- Teachers, state employees, police officers, local employees
- Balance roles with regard to different plans and trusts: 457(b) Plans, 403(b) Plans, 401(a) Plans.

Duty of Impartiality

- UMPERSA Commentary: "Differing interests are inevitable in the retirement system setting. Differences can arise between retirees and working members, young members and old, long- and short-term employees, and other groupings of those with interests in the retirement system. The duty of impartiality does not mean that fiduciaries must accommodate such interests according to some notion of absolute equality. The duty of impartiality … requires that such decisions be made carefully and after weighing the differing interests."

Duty of Loyalty: Practical Impact

A fiduciary has a duty to act in the interest of the trust **as if it had no other competing interests to protect.**

- Cannot act for fiduciary's own interest
- Cannot be influenced by the interest of any third person/plan sponsor
- Must set aside the interests of the party that appoints the fiduciary
- Not an agent for the party that appoints fiduciary (Two-Hat Rule)

Requires **undivided loyalty** to members and beneficiaries.

Duty of Loyalty: Two-Hat Rule

- The 3rd Circuit has affirmed that "[a] fiduciary must discharge his duties with respect to a plan **solely in the interest of the participants and beneficiaries** ... for the **exclusive purpose of ... providing benefits to participants and their beneficiaries**; and ... defraying reasonable expenses of administering the plan." *Sweda v. Univ. of Pennsylvania*, 923 F.3d 320, 328 (3d Cir. 2019) (internal citations omitted).
- "[W]hen employers themselves serve as plan administrators, they assume fiduciary status 'only when and to the extent' that they function in their capacity as plan administrators…Thus, if an employer's decision whether or not to amend a benefit plan constituted a decision about plan 'administration,' then it would have to be made **solely with the interests of the covered employees in mind**." *Hozier v. Midwest Fasteners, Inc.*, 908 F.2d 1155, 1158-1159 (3d Cir. 1990).

2. Duty of Prudence

Duty of Prudence

Delaware Code § 2722(d) incorporates the **duty of prudence**:

> "The Board, its subcommittees, and each of their members shall discharge their duties with respect to each Plan solely in the interest of the participants and beneficiaries of such Plan and for the exclusive purpose of providing Plan benefits to participants and their beneficiaries, including defraying reasonable expenses of administering each such Plan, with ***the care, skill, prudence, and diligence*** under the circumstances then prevailing that a ***prudent person*** acting in a like capacity and familiar with such matters would use to attain the purposes of such Plan"

Duty of Prudence: Delegation

A fiduciary is able to delegate functions that a prudent fiduciary acting in a like capacity and familiar with those matters could properly delegate.

A fiduciary has a duty to delegate responsibilities outside of the fiduciary's expertise.

Delegation should not be overly broad and must be consistent with duties of care and caution, *e.g.*, terms of delegation must be prudent.

Duty of Prudence: Delegation *(cont'd)*

Documentation should be clear and consistent

- Set out specific duties in writing
- Ensure all delegated acts are approved by the fiduciary
- Require the delegate accepts all assigned duties

Delegation is a fiduciary act

- Must delegate **prudently and in accordance with the written plan**
- Must **monitor** the delegate
- Fees and costs must be **reasonable**

Duty of Care/Prudence – Importance of Delegation

Responsibilities that are outside the trustee's skill set

Secure and consider advice of experts

- The Board is authorized and empowered to make and enter into any and all contracts, agreements, or arrangements for goods and services necessary or desirable for carrying out the purposes of any of the Plans. 29 Del. C. § 2722(e)(3).

Duty with respect to Co-Trustees from ERISA and from the Restatement

- Settlor determines areas of responsibility
- Each trustee must take reasonable care to prevent a co-trustee from committing a breach of trust and to obtain redress if there is a breach

Duty of Prudence: Diversify *(cont'd)*

In investing and managing assets, a fiduciary with authority to invest and manage assets shall diversify the investments unless the trustee reasonably determines that it is not prudent to do so.

"The Board shall have the power and duty to maintain, invest, and reinvest the funds contributed into the Plans consistent with the standard of care . . . ." Del. Code § 2722(e)(4).

Duty of Prudence: Diversity

In investing and managing assets, a fiduciary with authority to invest and manage assets shall diversify the investments unless the trustee reasonably determines that it is not prudent to do so.

Tibble v. Edison Int'l, 135 S.Ct. 1823 (2015) a fiduciary has a "continuing duty of some kind to monitor trust investments and remove imprudent ones." at 1828-1829 (involving investment share versus retail share classes).

Duty of Prudence: Continuing Duty to Monitor *(cont'd)*

- Common law of trusts recognizes a continuing responsibility to monitor investments after initial selection:
  - "[A] trustee's duties apply not only in making investments but also in monitoring and reviewing investments, which is to be done in a manner that is reasonable and appropriate to the particular investments, courses of action, and strategies involved." Restatement (Third) of Trusts.
  - "The Board in the exercise of its sole discretion and without liability is specifically authorized to remove any of the Plans' funds from any financial institution and to reinvest the funds in a similar or different investment alternative at another financial institution at any time." Del. Code § 2722(e)(6).

Continuing Duty to Monitor: Practical Impact

- Conduct **regular investment reviews** comparing with peer groups and benchmarks
- **Compare** expenses and assets classes
- Determine whether certain investments/funds should be placed on a **watch list or replaced**
- Consider adoption of **Investment Policy Statement**

Lessons Learned From 403(b)/401(k) Fee Litigation

Fee Litigation: Background

- Fee litigation began in 2006, primarily against 401(k) defined contribution plan sponsors in the private sector typically alleging breach of fiduciary duties
- Mixed outcomes in courts, but settlements totaling in the millions (*e.g.*, $62 million with Lockheed Martin, $57 million with Boeing) have fueled litigation
- Since 2016, lawsuits have been filed against over 20 private universities and hospitals alleging similar breaches of fiduciary duty with respect to investment funds and fees in 403(b) plans

University 403(b) Fee Litigation

Claims being made in these lawsuits are like those made in the 401(k) lawsuits but have evolved in a significantly different statutory, regulatory, and industry environment than qualified 401(a) retirement plans.

Most of these cases have settled or were dismissed by the courts.

Several large public universities received freedom of information requests related to fees under their 403(b) and other retirement plans in 2019, suggesting that plaintiffs' law firms may be exploring similar cases against governmental plans which are exempt from ERISA. However, we are not aware of any recent activity in this area.

University 403(b) Fee Litigation

- Fiduciary standards make no distinction based on type of plan.
  - "Because of the modern-day similarity between the two retirement plans, the analysis of the fiduciary standards for 403(b) and 401(k) plans must be the same."
  - *Sweda v. University of Pennsylvania*, Order Dismissing Complaint, p. 13, No. 16-4329 (E.D. Pa. 9/21/2017)

University 403(b) Fee Litigation

- On January 24, 2022, the Supreme Court issued an opinion in *Hughes v. Northwestern University*, an excessive fee case the 7th Circuit had dismissed for failure to state a claim. The Supreme Court vacated the decision and remanded the case back to the 7th Circuit for reconsideration.
- The Supreme Court held there is an ongoing duty to monitor investments, and the fact that a plan has many good investments does not excuse the inclusion of poor investments.
- The immediate impact of the Supreme Court decision has been fewer court dismissals at early stages in the litigation – in other words, the courts appear (at least initially) to have interpreted the Supreme Court decision as relaxing the pleading standards.

Claims for Relief

- What do plaintiffs want?
  - Class certification.
  - Declaration of breach of fiduciary duty.
  - Restoration of losses and "make whole" remedy.
  - Removal of current fiduciaries.
  - Reformation of plan investments.
  - Attorneys' fees.

Who has been Named Defendant?

- Private Colleges/universities
- Investment committees and individual committee/board members
- Individual employees
  - VP of Human Resources
  - VP of Investments
- Investment advisors/consultants

Fee Litigation: Specific Allegations

Breach of Duty of Loyalty

- "Locked in" investments favoring record keeper
- Too many investment options leading to investment paralysis
- Excessive fees for plan administration that benefited record keeper

Breach of Duty of Prudence

- Unreasonable administrative fees (e.g., **revenue sharing**, lack of competitive bids, asset-based vs. flat fees)
- Selecting and retaining investments with high fees and poor performance
- Investment options too numerous
- Flawed process for selecting and monitoring investments.
- Multiple record keepers increasing costs
- "Locked in" arrangement with vendor

Breach of Duty of Independence

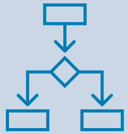
- Use of plan information to market other products outside the plan

Best Practices for Mitigating Liability

Statutory Indemnification

Delaware law provides statutory/qualified immunity. 29 Del. Code § 2722(f)(2); Ch. 40, title 10

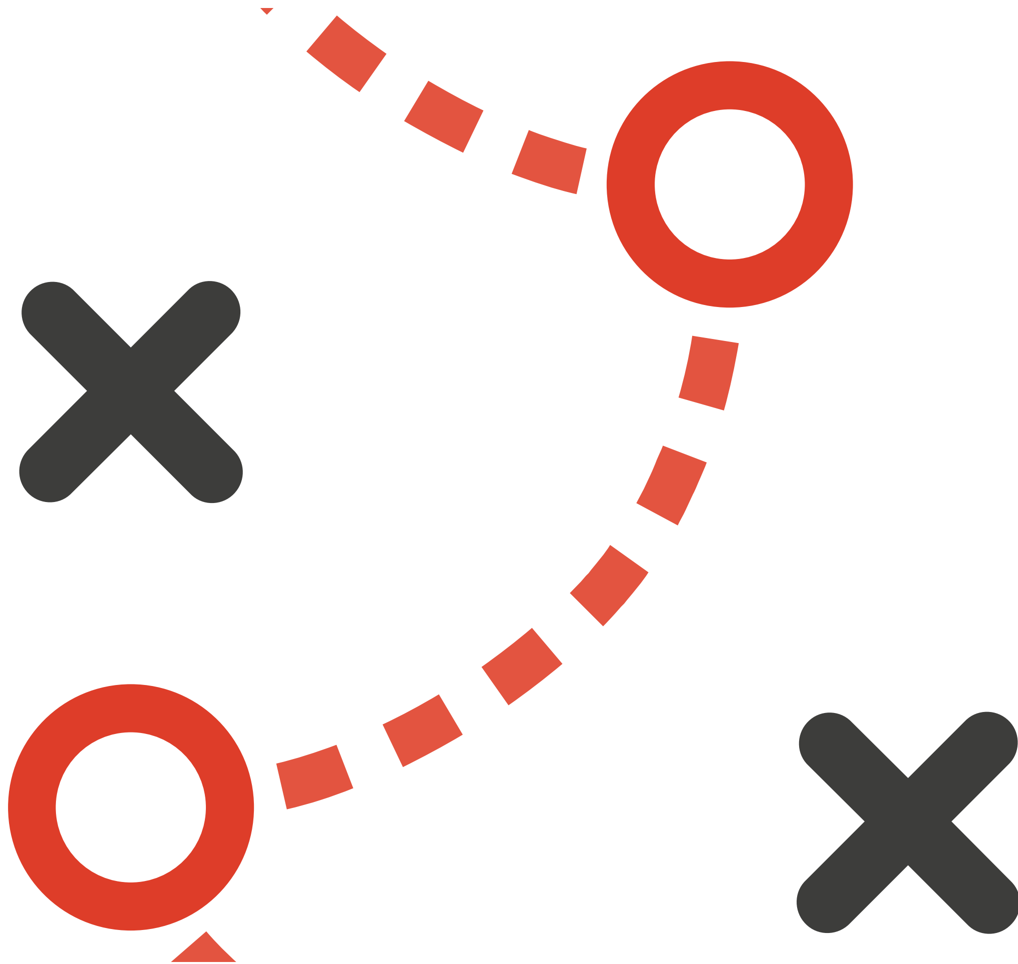
The Focus On Process



Focus on **procedural prudence**

Courts have held the test of prudence is one of conduct and process, and not one of result

"Trustees and fiduciaries are not insurers. Not every investment or management decision will turn out in the light of hindsight to have been successful. Hindsight is not the relevant standard." UMPERSA § 10(1)



The Focus On Process

- There is no one "right" way to achieve procedural prudence
- Important to have a good, documented process
- Critical to follow that process
- Critical to retain expertise where needed and understand expert advice
- Know and follow plan documents

Mitigating Fiduciary Risk

- Adopt written prudent processes and procedures and follow them:
  - Governance Manual
  - Vendor Management, Cybersecurity, and Other Policies
  - Charters for Committees
  - Investment Policy Statements
- Consider facts and circumstances that fiduciary knows or should know are relevant

Managing Fiduciary Risk

- Document decisions and the basis for decisions
- Conduct periodic training of fiduciaries
- Retain expertise where needed
- Properly allocate fiduciary roles in writing
- Conduct financial and management audits

Managing Fiduciary Risk

Due diligence in selecting and monitoring investment managers/actuaries/other consultants and advisors

Prudently select and monitor investments/actuarial assumptions

Understand and negotiate plan fees and expenses

Get competitive bids from service providers

Negotiate contracts with service providers

Managing Fiduciary Risk

For delegated duties:

- Properly select those to whom duties are delegated *e.g.*, monitoring performance of actuary and supervisory staff

Retain expertise where needed

Consider fiduciary insurance

Avoid conflicts of interest

Other Topics to Watch

Other Topics to Watch

ESG ("Environmental, Social, Governance")

Proxy Voting

ESG Considerations

- 1994 – Department of Labor (“DOL”) issues Interpretive Bulletin (“IB”) 94-1
  - A prudent investment should include a thorough consideration of the expected return on alternative investments that have similar risk and reward factors as other investments currently available in the plan.
  - If the standards are met, the selection of an Economically Targeted Investment (“ETI”) does not violate ERISA
  - Defines ETIs as “investments selected for the economic benefits they create apart from their investment return.”
- 2008 – IB 2008-01 established that a Plan may consider factors other than investment return (“ESG Factors”) as a “tie-breaker” when alternative investments are economically equivalent

ESG Considerations *(cont'd)*

- Observed that ERISA does not specifically provide a basis for selecting between economically equivalent investments
- Economic interests of a plan are protected when there is economic equivalence between investment selections
- In such situation choosing between economically equivalent investments based on ESG Factors is consistent with ERISA
- To rely on ESG Factors, fiduciaries "must first have concluded that the alternative options are truly equal, taking into account a quantitative and qualitative analysis of the economic impact on the Plan."
- Fiduciaries generally must establish a written record demonstrating the economic equivalence of investment alternatives

ESG Considerations *(cont'd)*

- 2015 – IB 2015-01
  - Issued out of concern that the 2008 guidance was dissuading fiduciaries from pursuing investment strategies that considered ESG Factors
  - Clarifies that fiduciaries "should appropriately consider factors that potentially influence risk and return," and ESG Factors "may have a direct relationship to the economic value of the plan's investment."
  - DOL does not believe ERISA prohibits a fiduciary from addressing ETIs or incorporating ESG factors
  - Reiterates the importance of documentation of investment decisions relying on ESG Factors
- 2020 – on November 13, 2020, the DOL published its final rule on fiduciary duties and their application to ESG Factors ("Investment Duties Rule").
  - It goes back to IB 2008-01 and requires that a fiduciary evaluated investment or investment course of action based only on "pecuniary factors," unless the fiduciary is unable to distinguish the investments on the basis of pecuniary factors alone.

ESG Considerations *(cont'd)*

- A fiduciary may not "subordinate the interests of participants and beneficiaries . . . to other objectives and may not sacrifice investment return or take an additional investment risk to promote non-pecuniary benefits or goals."
- The fiduciary is required to document (in part):
  - Like pecuniary factors were not sufficient to select the investment
  - How the selected investment compares to alternatives
  - How the non-pecuniary factor(s) is/are consistent with the interests of participants and beneficiaries and their financial benefits.
- March 2021 – DOL announces that it will not enforce the Investment Duties Rule. The DOL notes that the final rule was said to have "a chilling effect on appropriate integration of ESG factors in investment decisions."

ESG Considerations *(cont'd)*

October 13, 2021 - DOL issues proposed regulations that specifically permit plan fiduciaries to consider ESG factors that are material to a risk-return analysis when considering and selecting plan investments and in voting proxies.

Includes climate change related factors, governance factors, and workforce practices.

Intended to clarify that ESG factors are to be considered on equal footing with more traditional financial factors.

Regulations have not been finalized

February 14, 2022 - DOL issued a request for information ("RFI") on possible DOL actions to protect retirement plan assets from climate related financial risk. Based on the scope of the RFI, we expect to see more ESG related guidance going forward.

Voting Proxies/DOL Guidance

- Similar history as to ESG investing.
- IB 94-2 – Fiduciary duties applicable to the management of stock assets including the voting of proxies appurtenant to those shares
  - Fiduciary duties require that a fiduciary periodically monitor the activities of the investment manager, including with regard to proxy voting.
  - Endorses shareholder activism to the extent that it is "likely to enhance the value of the plan's investment."

Voting Proxies/DOL Guidance *(cont'd)*

- Advisory Opinion 2007-07a – fiduciaries, when considering whether to support or oppose a proxy proposal or engage in other activities to influence management, must first consider the cost of such action and the role of the investment in the plan's portfolio
  - Fiduciaries may not increase expenses, sacrifice investment returns, or reduce the security of plan benefits to support or promote goals not directly related to the plan.

Voting Proxies/DOL Guidance *(cont'd)*

- 2016 – IB 2016-01 – Rescinded IB 2008-01
  - Rescinded IB 2008-01 and responded to concerns that 2008-01 was articulating a general rule that broadly prohibited plans from exercising shareholder rights, including the voting of proxies, unless the plan has performed a cost-benefit analysis and concluded in the case of each particular vote or exercise of shareholder rights that the action is more likely than not to result in a quantifiable increase in the economic value of the plan's investment.
  - Consistent with the common law of trusts, the fiduciary act of managing plan assets that are shares of stock includes the voting of proxies appurtenant to those shares
  - A delegating fiduciary is responsible for monitoring the fiduciary's procedures and actions

Voting Proxies/DOL Guidance *(cont'd)*

- 2020 – DOL announces that IB 2016-01 "no longer represents the view of the DOL."
- December 16, 2020, the DOL published a final rule on the application of fiduciary duties to proxy voting.
- Identifies the right to vote proxies as a shareholder right that is appurtenant to shares of stock that are plan assets. Imposes general requirements on plan fiduciaries for deciding whether to exercise shareholder rights. Factors include:
  - Acting solely in accordance with the economic interests of the plan and its participants and beneficiaries;
  - Considering any costs involved;
  - Not subordinating the interests of participants and beneficiaries and their retirement income of financial benefits to any non-pecuniary objective.

Voting Proxies/DOL Guidance *(cont'd)*

- March 2021 – DOL issues a policy statement of non-enforcement
  - Shareholder activism is consistent with fiduciary duties if there is a reasonable expectation that the particular form of activism is likely to enhance the value of the plan's investment, considering all costs involved.
  - Proxies may be voted as part of the normal process of managing investments unless a fiduciary determines that the time and costs may not be in the plan's best interests.
  - October 14, 2021 – Proposed Rule on Exercising Shareholder Rights published in Federal Register

Small Balance Cash Outs and Escheatment

Small Balance Cash Outs

- Many plans allow for the immediate distribution of a terminated participant's benefit without the participant's consent
- Distributions of $1,000 or less may be automatically cashed out to the participant and are not subject to the automatic rollover requirements
- If the distribution is greater than $200, the participant must be provided with a Special Tax Notice for any eligible rollover and must be given the opportunity to roll over the distribution

Small Balance Cash Outs

- For eligible rollover distributions over $1,000, mandatory distributions must be paid in a direct rollover to an IRA (unless the distributee elected otherwise).
- Distributee must receive a Special Tax Notice explaining rollover rights.
- Plan must establish an IRA with a financial institution (or internally under a "deemed IRA" program) on the distributee's behalf and notify the distributee.

Small Balance Cash Outs

- Not uncommon for plans to do mandatory distributions of $1,000 or less.
- Some plans have expressed difficulty in working with IRA vendors to roll over small accounts and are hesitant to create IRA accounts for lost members/beneficiaries.
- Governmental plans tend to retain the assets in the participant or forfeiture accounts, but we anticipate IRA vendors becoming more open to such accounts.

Escheatment (Unclaimed Property Fund)

- When there is a requirement that "abandoned" governmental retirement plan property be transferred to a state's unclaimed property fund, it raises federal tax law concerns regarding whether the transfer:
  - violates vesting provisions applicable to governmental plans;
  - violates the "exclusive benefit rule";
  - constitutes a prohibited transaction under Code § 503; or
  - violates the rollover rules.

Escheatment (Unclaimed Property Fund)

- No federal laws or case law expressly provide that transferring assets from an on-going plan to a state unclaimed property fund would satisfy the exclusive benefit rule.
- The Internal Revenue Manual includes the option but only in the case of a terminated defined contribution plan and only after significant efforts to locate the participant.

Escheatment (Unclaimed Property Fund)

- If funds are transferred to a state unclaimed property fund, the transfer would likely be considered a "distribution"
- Distributions would be subject to mandatory rollover rules
- Form 1099-R instructions provide that "[p]ayments made from IRAs to state unclaimed property funds must be reported on Form 1099-R."

IRS Form 1099-R Instructions, p.3; Rev. Rul. 2018-90

Escheatment (Unclaimed Property Fund)

- The U.S. Government Accountability Office (“GOA”) recently released a report examining the transfer of unclaimed retirement savings to a state's unclaimed property fund from IRAs and employer plans.
- In 2016, $35 million in unclaimed retirement savings was transferred to the 17 states responding to the survey from IRAs and employer plans, with 84% of that amount ($22.4 million) deriving from the assets and uncashed checks of employer defined contribution plans.
- Importantly, according to available data, approximately 97% of the amount transferred from employer plans derived from **terminated plans**.

U.S. Government Accountability Office, Federal Action Needed to Clarify Tax Treatment of Unclaimed 401(k) Plan Savings Transferred to States, GAO-19-88 (January 2019)

Escheatment (Unclaimed Property Fund)

- The GAO report and a subsequent DOL response have clarified:
  - There is widespread agreement on the need for guidance as to whether and when unclaimed property related to ERISA plans may be transferred to state custody.
  - The DOL is considering issuing such guidance in the future, potentially in the form of regulations, and potentially allowing some unclaimed funds to be transferred from ERISA plans to state unclaimed property funds.
  - Most funds currently transferred from employer plans to state unclaimed property funds are from terminating plans, not active plans, suggesting that most ERISA plans do not transfer unclaimed property to the states.
  - Whether the DOL will issue guidance on the transfer of unclaimed property from ERISA plans is unclear. We continue to watch for new guidance and/or regulations from the DOL.

Questions?

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