

# Delaware OST Fiduciary Topics



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# Agenda

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**Fiduciary Basics**

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**Fiduciary Duties**

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**Recent Fee Litigation**

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**Best Practices for Managing Liability**

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**Other Topics to Watch**

# Fiduciary Basics

# Fiduciary Training

Fiduciary  
training  
helps  
fiduciaries  
to:

- Understand their fiduciary responsibilities
- Manage risks from a legal and compliance perspective

# Fiduciary Defined



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

# Who is a Fiduciary?

- The Plan Sponsor determines the scope of authority of the fiduciaries and gives authority to the Plans Management Board by statute. The Plan Sponsor is not a fiduciary.
- 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 Plan documents.
- The term "fiduciary" includes any "trustee" and "agents to the extent delegated duties by another fiduciary." 12 Del. C. § 3301(d).

# Who is Not a Fiduciary?

- Plan Sponsor.
- Third party administrators and recordkeepers are not fiduciaries if solely performing ministerial functions.
- Typically, vendor agreements will affirmatively state whether the vendor is a fiduciary (often they are not).
- Exception if providing investment advice to participants (e.g., through brokers, relationship managers, or third parties like Ibbotson or Morningstar)
- Exception if providing rollover advice to participants.

# Sources of Fiduciary Duty

## Federal Law

- **Internal Revenue Code**
- **ERISA** (not directly applicable, but excellent resource)
- **Uniform Prudent Investor Act** (“UPIA”)

## State Law

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

## Common Law

- **Restatement (Third) of Trusts** (collection of common law)
- **Uniform Management of Public Employees Retirement Systems Act**

## Plan and Plan-Related Documents

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



# Typical Fiduciary Activities:

Appointing other plan fiduciaries, *e.g.*, investment advisor, recordkeeper

Delegating responsibilities to other fiduciaries

Selecting/monitoring plan investments

Acquiring/disposing of plan assets

Interpreting plan provisions

Making decisions under the plans

# Fiduciary Duties

Duty of Loyalty

Duty of Prudence

Duty to Follow Plan Documents

# Duty of Loyalty

# Duty of Loyalty

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**Duty to act solely in the interest of participants and beneficiaries**

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

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**Duty to act independently and without conflicts of interest**

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**Duty to act impartially among differing interests**

# 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”**

# Duty of Loyalty: Exclusive Benefit Rule

- Delaware Code § 2722(d) incorporates the duty of loyalty, providing that “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

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. . . ."
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.
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.
529/529A Plans 29 Del. Code § 2722(d)(2).	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. "



# Duty of Loyalty: Independence

A fiduciary has a duty to act in the interest of the members and beneficiaries **as if there were no other competing interests to protect.**

- Cannot act for fiduciary's own personal or business interest.
- Cannot be influenced by the interest of any third person.
- **Must set aside the interests of the party that appoints the fiduciary.**
- **Not an agent for the party that appoints fiduciary.**

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

# Duty of Loyalty: Independence

"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

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

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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).

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*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

Balance the interests of different types 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 Loyalty: Impartiality

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A trustee who wears “two hats” can only wear the trustee’s fiduciary hat when acting in fiduciary capacity as a Board member.

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Interests relating to the “other hat”—be it teacher, state employee, retiree, governor’s office, etc.—must be set aside. The Board member can only act in the independent, undivided interests of the members and beneficiaries.

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Board members are not there to represent the interests of the group that elected or appointed them.

# Duty of Impartiality - Delaware Law

- The 3<sup>rd</sup> 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).

# 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 Impartiality - – Oregon Supreme Court Case

- The Oregon Supreme Court has held that common law trust principles require a public pension board to consider not only the amount of income or near-term benefits to beneficiaries, but also the need to preserve and protect the fund corpus.
- The Court noted this is particularly important where the fund has tens of thousands of beneficiaries in widely varying circumstances, including active participants just entering service to active participants close to retirement, as well as retirees in various stages of retirement. The Board must fulfill its duty of impartiality.
- “[The Board] must first comply with specific statutory mandates and prohibitions and, when exercising its discretion beyond those requirements, must consider the diverse interests of PERS and *all* PERS beneficiaries.” *White v. Public Employees Retirement Board*, 268 P.3d 600 (Or. 2011)(Emphasis in the original.)

# Duty of Loyalty - Expenses

A fiduciary shall discharge duties with respect to the plan incurring only costs that are appropriate and reasonable to administer the plan.

- Fee transparency.
- Understand what and how fees are paid.
- Only reasonable expenses can be paid.

# Duty of Prudence

# Duty of Prudence

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**Duty to act with the care, skill, prudence, and diligence that a prudent person would exercise in managing their own affairs**

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**Duty to be informed**

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**Duty to delegate responsibilities outside of experience**

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**Duty to diversify investments**

# Duty of Prudence – Be Informed

The fiduciary has a duty to **be informed** with respect to the decisions he or she is required to make.

Regularly attend meetings.

Review materials provided at meetings.

Request materials and ask questions to ensure adequate information before taking action.

Be familiar with governing documents, including the statutes and administrative guidance applicable to the plans.

Secure and consider advice of experts on reasonable basis but exercise independent judgment.

# Duty of Prudence: Delegation

"If you don't know jewelry,  
know the jeweler."

- **Warren Buffett**



# Duty of Prudence: Delegation

A fiduciary can 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

## Delegation 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 state laws and plan terms
- Must monitor the delegate
- Fees and costs must be reasonable



# Duty of Prudence: Delegation

Prudent selection and retention of expertise.

May reasonably rely on expertise.

Failure to follow expertise could be a violation of fiduciary duties.

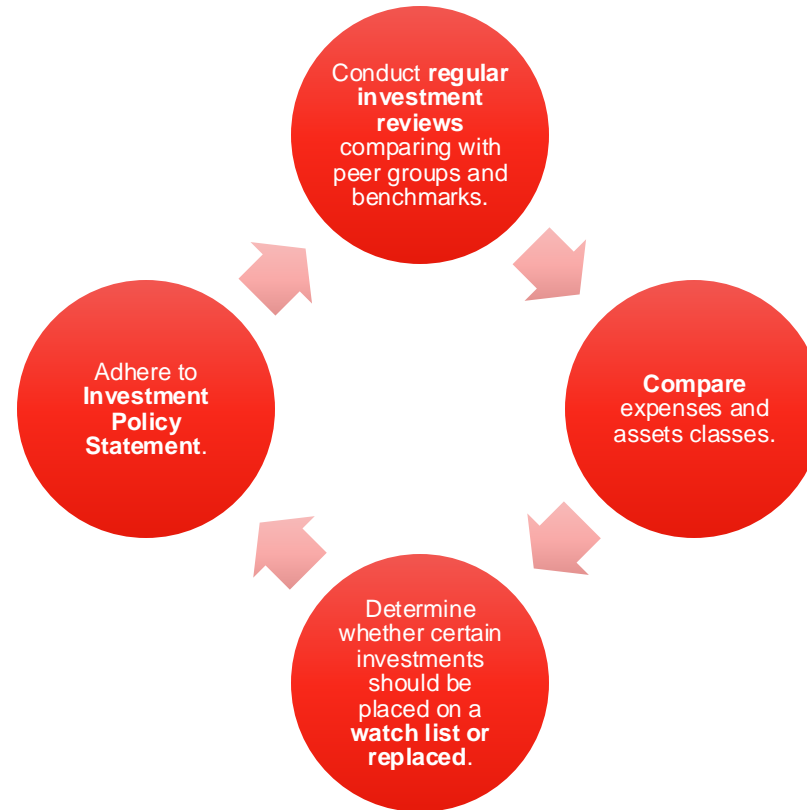
- If a fiduciary does not have the knowledge/skills, they must consult/hire a subject matter expert pursuant to a prudent process.

Retain reasonable oversight and ask appropriate questions.

# Duty of Prudence: Diversification

- Duty to diversify the investments of the plan to minimize investment risks within the portfolio, unless under the circumstances it is not prudent to do so.
- Fundamental to the prudent management of risk.
- Failure to diversify and too much diversification each have led to claims against fiduciaries.

# Duty of Prudence: Duty to Monitor



# Affirmative Duty to Follow Terms

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

It could include the statutes, administrative rules, and administrative procedures/policies

Consistent interpretation and administration

Timely update for legally required changes

Timely correct errors



Burden on fiduciary to understand the governing documents of the Plans, and the context in which the Plans exists.

# Negative Duties: Prohibited Transactions

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## A fiduciary may not:

Deal with Plan assets in their own interest.

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Pay unreasonable compensation for services performed.

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Make a purchase for more than adequate consideration or a sale for less than adequate consideration.

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Act on behalf of a party whose interests are contrary to the Plans or participants.

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Receive anything of value from any party in connection with a transaction involving Plan assets.

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# Key Takeaways



Highest duty under the law.



## Objective standard:

- Prudent "person" standard.
- Good faith is not sufficient.
- If you don't know, learn or hire an expert.



If it is not documented, it cannot be substantiated.

# Fiduciary Liability

# Fiduciary Liability



**Personal liability** for breach of fiduciary duty.

Restore to the Plans any losses resulting from a breach of fiduciary duty.  
Restore to the Plans any profits made by the fiduciary through use of plan assets.  
Other equitable or remedial relief as the court may deem appropriate.



May be liable for a co-fiduciary's breach of fiduciary duty if a fiduciary enables another fiduciary to commit the breach, knowingly participates in or conceals the breach, or discovers the breach but does not take steps to remedy.



# Recent Fee Litigation

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# Background



Fee litigation began in 2006, primarily against 401(k) defined contribution plan sponsors in the private sector

Claimants typically allege 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

In 2016, a new round of lawsuits against private universities related to governance and administration of 403(b) plans

# General Allegations

- Complaints *generally* allege:
  - Employer did not use its **bargaining power** to demand lower-cost services or less expensive funds.
  - Employer did not exercise **proper judgment** in deciding what investment options to include in plans.
  - Employer action or inaction violated **duty of prudence** and **duty of loyalty** under ERISA.
- Cases challenge **plan governance**.

# 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

# Characteristics of Lawsuits



Primarily plans with participant investment direction



Started out targeting large plans, but now all size plans



ERISA-covered plans; not governmental plans (but see *Cattau v. Neenah Joint School District et al.*)



Often cases are settled or dismissed

# Supreme Court Decision

- On January 24, 2022, the Supreme Court issued an opinion in *Hughes v. Northwestern University*, a 403(b) 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 reaffirmed there is an ongoing duty to monitor investments, and the fact that a plan which has many good investments does not necessarily excuse the inclusion of poor investments.
  - The immediate impact of the Supreme Court decision has been mixed, with some courts dismissing cases earlier and others not.

# New Litigation Approach

- Fee litigation since 2006 largely assert a breach of fiduciary duty in selecting investment options with excessive fees.
- In 2022, several lawsuits filed which assert a breach of fiduciary duty due to selecting investment options with below market performance even though low fees, e.g., Blackrock target date funds.
- Largely unsuccessful so far.

# Other Areas of Target

- Managed account options
- Application of ESG factors (*Spence v. American Airlines*)
- Cybersecurity breaches
- Plan forfeitures
- In the future - Use of artificial intelligence?



# Best Practices for Mitigating Liability

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# Sovereign Immunity



State Constitution or statutes may provide some protection

# 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

# 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 terms of the Plans and Programs



# Managing Fiduciary Risk

Adopt written prudent processes and procedures and follow them:

- Governance Policy
- Conflicts of Interest Policy
- Ethics Policy
- Charters for Committees
- Investment Policy Statement
- Cyber and Data Security Policy

Consider facts and circumstances that fiduciary knows or should know are relevant.

# Managing Fiduciary Risk

- Document decisions and the basis for decisions
- Conduct initial and periodic training of fiduciaries
- Properly allocate fiduciary roles in writing
- Conduct financial and management audits
- Provide accurate participant communications



# 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 for the Plans

Avoid conflicts of interest

# Managing Fiduciary Risk

- Due diligence in selecting and monitoring actuaries/other consultants and advisors
- Service Provider Oversight (vendor management)
- Prudently select and monitor investments and actuarial assumptions
- Understand plan expenses
- Get competitive bids from service providers
- Negotiate contracts with service providers



# Other Topics to Watch

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# Cybersecurity

On April 12, 2021, the DOL issued three pieces of cybersecurity guidance for retirement plans clearly stating that cybersecurity is a fiduciary issue.




Several recent lawsuits against recordkeepers as a result of theft of plan accounts.

Focus on call center vulnerabilities.

Request restoration of account.

Allege fiduciary duty to put in place adequate cyber theft protection.



Some recordkeepers are now covering losses due to unauthorized activity so long as member safeguards account access information and reports fraud immediately.

# ARTIFICIAL INTELLIGENCE



## Liability Risk

Privacy  
Bias  
Accuracy  
Intellectual Property  
Transparency



## Best Practices for Mitigation

Appropriate guardrails and governance  
Update employee policies and provide training  
Review contractual terms and privacy policies for AI  
Incorporate AI into third-party and data privacy risk assessments  
Annual review to incorporate any updates

# Correction of Overpayments

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Under the SECURE 2.0 Act of 2022, effective Dec. 29, 2022, qualified plans are provided flexibility in regard to seeking recovery of inadvertent benefit overpayments.

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A qualified plan is not disqualified as a result of an inadvertent benefit overpayment, but fiduciary obligations still apply.

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It is important to apply consistent correction procedures for similarly situated participants.

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We anticipate the IRS will issue further guidance on recovery of inadvertent benefit overpayments.

# ESG Considerations

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Next area of expected litigation is ESG = Environmental, Social, Governance; has attracted local and national political attention.

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ESG investing is a model of investing where investments are selected in part for their **collateral** economic or social benefits apart from the investment return to the retirement plan investor.

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Litigation anticipated regarding whether ESG funds are truly ESG and/or whether ESG funds are a prudent investment.

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Has attracted local and national political attention.

# Questions?



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