Delaware OST Fiduciary Topics

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Agenda

Fiduciary Basics

Fiduciary Duties

Fiduciary Litigation Overview

Best Practices for Managing Liability

Other Topics to Watch

Fiduciary Basics

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Fiduciary Training

Fiduciary training helps fiduciaries to:

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

Who is a Fiduciary?

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

- ✓ The term “fiduciary” includes any “trustee” and “agents to the extent delegated duties by another fiduciary.” 12 Del. C. § 3301(d).
- ✓ Management Board administers: State’s Deferred Compensation 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), and, effective January 1, 2026, Delaware EARNS (auto-IRA program). 29 Del. C. § 2722

Trustees, staff acting with delegated authority and agents of the Board: both by function and designation

- ✓ Internal Revenue Code § 4975(e)(3); ERISA § 3(21)

Who is <u>Not</u> a Fiduciary?

- The Plan Sponsor.
- Attorneys, accountants, and actuaries generally are not fiduciaries when acting in their professional capacities, unless a contract provides otherwise
- 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

DELAWARE EARNS

- State-sponsored automatic-enrollment IRA (“auto-IRA”) program for private-sector workers whose employers do not offer a retirement plan.
- The program launched in July 2024.
- Administration of EARNS was transferred to the Plans Management Board effective January 1, 2026.
- EARNS accounts are individual retirement accounts governed by Code § 408.
- ***Participating employers are <u>not</u> fiduciaries of the program***.
  19 Del. C. § 3804(3)

Sources of Fiduciary Duty

Federal Law	State Law	Common Law	Program and Program-related documents
• **Internal Revenue Code** • **ERISA** (not directly applicable, but excellent resource) • **Uniform Prudent Investor Act** (“UPIA”)	• **Statutory Fiduciary Rules** • **State Constitution** • **Program Statutes** • **Administrative Code**	• **Restatement (Third) of Trusts** (collection of common law) • **Uniform Management of Public Employees Retirement Systems Act**	• **Disclosure Statement** • **Participation Agreement** • **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

- Duty to act solely in the interest of participants and beneficiaries
- Duty to act for the exclusive purpose of providing benefits or paying reasonable plan expenses
- Duty to act independently and without conflicts of interest
- Duty to act impartially among differing interests

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
- Both a qualification requirement and a fiduciary obligation for 401(a), 403(b), and 457 plans.
- Prior to satisfaction of all liabilities, no asset, corpus, or income of the trust may be used for any purpose other than the exclusive benefit of members and beneficiaries.
- Compliance is reviewed in both form and operation:
  - Payments must be made solely to members and their beneficiaries
  - Payments to beneficiaries must be incidental to payments made to the member

Exclusive Benefit Rule: DC Plans and IRAs v. 529 and ABLE Plans

DC Plans and IRAs

- **401(a) Match Plan:** corpus or income may never be diverted to purposes other than the exclusive benefit of employees or their beneficiaries.
- **403(b) Plan:** a custodial account cannot be diverted from the exclusive benefit of the participant.
- **457(b) Plan:** assets must be held in trust for the exclusive benefit of participants and beneficiaries.
- **Delaware EARNS (Auto-IRA):** IRAs must be maintained for the exclusive benefit of participants and beneficiaries and comply with Code § 408; failure permanently ends IRA tax status.

529 and ABLE Plans

- **Different Code sections:** not governed by the same exclusive benefit provisions; the common law of trusts applies.
- **Expressly allowed by statute:** 29 Del. C. § 2722(d)(2) authorizes administrative fees to defray reasonable expenses, including marketing, and to fund scholarship, match, or promotional programs.
- **Expressly allowed by trust:** permits an “Administrative Fund” to pay reasonable expenses and fees, including salary, marketing, and other administrative expenses.
- **Consistent with other 529 plans:** a different legal landscape from qualified retirement plans.

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

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

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

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

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.

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

Duty of Impartiality - Delaware Law

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).

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

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

Duty to be informed

Duty to delegate responsibilities outside of experience

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 to delegate responsibilities outside of experience
  - A fiduciary can delegate functions that a prudent fiduciary acting in a like capacity and familiar with those matters could properly delegate
- ✓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: Investments

Duty to diversify the investments unless not prudent to do so.

- Fundamental to the prudent management of risk
- Duty of prudence in selecting individual investments
- Failure to diversify and too much diversification each have led to claims against fiduciaries.

Continuing duty to monitor investments.

- Conduct regular investment reviews comparing with peer groups and benchmarks
- Compare expenses and assets classes
- Determine whether certain investments should be placed on a watch list or replaced
- Adopt (and adhere to) Investment Policy Statement (“IPS”)

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.

Duty to Follow Plan Document

- Fiduciary duty to administer a plan in good faith in accordance with its written terms – "**by the book**."
  - Plan may include the **statutes**, administrative **rules**, and administrative **procedures/policies**
  - **Consistent** interpretation and administration
  - Timely **update** for legally required or operational changes
  - Timely **correct** plan errors
- Burden on fiduciary to understand the governing documents of the plan, and the context within which the plan exists.

Prohibited Transactions

A fiduciary may not:

- Deal with plan assets in his/her own interest.
- Pay unreasonable compensation for services performed.
- Make a purchase for more than adequate consideration or a sale for less than adequate consideration.
- Act on behalf of a party whose interests are contrary to the plan or participants.
- Receive anything of value from any party in connection with a transaction involving plan assets.

Fiduciary Litigation Overview

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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.
- **Practical Takeaway**: Courts are increasingly open to recordkeeping-fee and share-class claims surviving a motion to dismiss. A documented, regularly monitored process (including periodic recordkeeper fee benchmarking and evaluation of available lower-cost share classes) remains the best defense.

New Litigation Approach

Below-Market-Performance / Target-Date-Fund Theory

- Fee litigation since 2006 has largely asserted a breach of fiduciary duty in selecting investment options with excessive fees.
- Since 2022, several lawsuits have asserted a breach of fiduciary duty based on selecting investment options with below-market performance despite low fees (e.g., BlackRock LifePath target date funds.
- Largely unsuccessful: courts have repeatedly dismissed these suits for failing to identify a "meaningful benchmark" fund and for underperformance that was not "substantial" or "consistent" enough to plausibly show imprudence.
- **Issue to watch**: a circuit split now sits before the Supreme Court on how rigorous that benchmark comparison must be (6th Cir. Johnson v. Parker-Hannifin vs. 9th Cir. *Anderson v. Intel Corp.*). The DOL has filed an amicus brief supporting the stricter "meaningful benchmark" standard.

Stable Value Fund Litigation

- A newly popular theory: roughly 30 lawsuits filed in 2025 alone (up from fewer than five in 2024).
- Allegations include below-market crediting rates, failure to renegotiate wrap/general-account contracts, unduly conservative design relative to peer benchmarks, and structural defects (e.g., insurer selection).
- Outcomes are mixed at the motion-to-dismiss stage. Many dismissed for lack of a comparable benchmark fund, but some have survived to summary judgment and trial, particularly where fiduciaries restricted their consultant's review or disregarded recommendations to exit an underperforming fund.

Fiduciary Liability and Risk Mitigation

Delaware Law: Immunity

- **Statutory immunity:** the Board, its subcommittees, and their members are entitled to the immunities under Chapter 40 of Title 10.
- **No individual liability:** a member is not liable for any act or omission made during the member's tenure, or for any loss incurred by any person as a result of participation in any of the Plans.
- **State indemnification:** the State shall indemnify a member who is party to, or threatened with, any civil, criminal, administrative, or investigative proceeding arising from Board or subcommittee service, covering expenses, judgments, fines, and settlement amounts.
  - **Conditions:** the member acted in good faith and in a manner reasonably believed to be in the best interest of the State, and, in criminal matters, had no reasonable cause to believe the conduct was unlawful.
  - **Attorneys' fees** are covered if the Attorney General determines the member is not entitled to representation by the State.

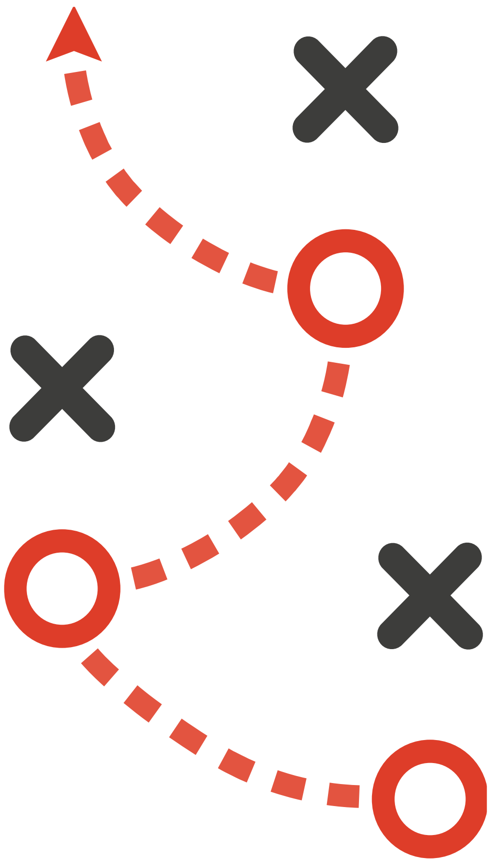
29 Del. C. § 2722(f)(2)

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
- 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 Program



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 Program

Avoid conflicts of interest

Managing Fiduciary Risk

- Due diligence in selecting and monitoring actuaries/other consultants and advisors
- Prudently select and monitor investments and actuarial assumptions
- Understand program expenses
- Get competitive bids from service providers
- Negotiate contracts with service providers

Other Topics to Watch

Cybersecurity

- DOL cybersecurity guidance was issued in 2021 and updated in 2024 to apply to all ERISA-covered plans.
- The 2024 update emphasizes vendor oversight, cybersecurity insurance, multifactor authentication, and breach notification.
- Participant account takeover litigation continues against recordkeepers and other service providers.
  - Claims often focus on call-center authentication and online account access controls.
  - Plaintiffs frequently seek restoration of stolen account balances and allege failures to maintain reasonable cybersecurity safeguards.
- The Board should regularly review cybersecurity practices, vendor controls, incident response procedures, and cyber-insurance coverage.

Artificial Intelligence

Emerging Fiduciary Considerations

- AI is increasingly being used by retirement systems, administrators, recordkeepers, consultants, and investment managers.
- Key risks include data privacy, cybersecurity, accuracy, bias, and inappropriate disclosure of confidential information.
- AI outputs can assist decision-making, but fiduciaries remain responsible for exercising independent judgment.
- Vendor use of AI may create contractual, intellectual property, and data-governance risks.

Board Oversight Priorities

- Understand how service providers and investment managers are using AI in connection with plan operations and participant services.
- Confirm appropriate controls exist for confidential participant, beneficiary, and employer data.
- Review vendor contracts, security provisions, and data-use terms for AI-related risks.
- Ensure AI use is addressed within cybersecurity, privacy, and third-party risk-management programs.

Correction of Overpayments and Administrative Errors

Qualified Plans

- SECURE 2.0 provides significant flexibility for correction of inadvertent benefit overpayments.
- A plan generally will not fail qualification merely because it does not recover an inadvertent overpayment.
- Fiduciary duties still apply when determining whether, and how, to pursue recovery.
- Apply correction procedures consistently for similarly situated participants.

Delaware EARNS

- SECURE 2.0 expanded EPCRS to cover eligible inadvertent IRA failures.
- IRS Notice 2023-43 confirmed that IRA correction procedures are not yet fully operational pending additional IRS guidance.
- Certain IRA failures, including missed RMDs and some erroneous beneficiary distributions, are expected to be addressed.
- Monitor future IRS guidance affecting IRA correction procedures.

ESG Considerations

ESG (Environmental, Social, Governance) issues continue to attract legal, regulatory, and political attention.

Fiduciaries must focus on risk, return, and the interests of participants and beneficiaries.

Understand how investment managers incorporate ESG-related considerations into investment decisions.

Review proxy voting practices.

Document the rationale for investment decisions.

QUESTIONS?