



# Common Fiduciary Errors and How to Avoid

Add value as the Advisor

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## “Share Class” ERISA Litigation

- Act Section 404(a)(1)(A): Fiduciaries must discharge their plan-related duties "for the exclusive purpose of . . . providing benefits to participants and their beneficiaries; and . . . defraying reasonable expenses of administering the plan.
- Kong v. Trader Joe’s Company (9<sup>th</sup> Cir. Apr 15, 2022)
  - Failure to monitor and control the offering of a number of mutual funds in the form of "retail" share classes that carried higher fees than those charged by otherwise identical "institutional" share classes of the same investments.
  - Except for the extra fees, the share classes were identical.
  - Court reasoning:
    - “[w]asting beneficiaries’ money is imprudent.”

## “Share Class” ERISA Litigation

- Davis v. Salesforce.com, Inc.
  - Plaintiffs identify two lower-cost JPMorgan share classes (R5 and R6) that they allege were available substitutes for nine JPMorgan SmartRetirement mutual funds offered by the plan.
  - As to those nine JPMorgan funds, plaintiffs allege that “the more expensive share classes chosen by Defendants were the same in every respect other than price [as] their less expensive counterparts.”
  - Plaintiffs also alleged that defendants imprudently failed to investigate and timely switch to available collective investment trusts, which plaintiffs allege had “the same underlying investments and asset allocations as their mutual fund counterparts” but had a lower net expense ratio.

## “Share Class” ERISA Litigation

- Act Section 404(a)(1)(A): fiduciaries must discharge their plan-related duties "for the exclusive purpose of . . . providing benefits to participants and their beneficiaries; and . . . defraying reasonable expenses of administering the plan.
- Legal principle
  - “A trustee cannot ignore the power the trust wields to obtain favorable investment products, particularly when those products are substantially identical—other than their lower cost—to products the trustee has already selected.”

# How to Determine that Plan Fees are “Reasonable”

## Benchmarking Plan Services and Costs

- While the responsibility for “defraying reasonable expenses of administering the plan” is clear, the definition of “reasonable” is not.
  - ERISA does not define the word and government agencies only provide general guidance for evaluating 401(k) fees.
  - The Department of Labor (DOL) suggests “establishing an objective process to aid in your decision making”.

# How to Determine that Plan Fees are “Reasonable”

## Benchmarking Plan Services and Costs

- Tussey v. ABB (W.D Mo. Mar 31, 2012)
  - Plan fiduciaries need to compare one provider’s services against others and to do so using market-based data.
  - Specifically, the court noted “[t]o assess the prudence of a revenue sharing arrangement ABB had to determine the market rate for the recordkeeping services provided to the Plan. Without such a baseline, it would be impossible to determine whether a [particular] arrangement would add to the value of the . . . Plan.”[Emphasis added]
  - The court criticized ABB because it “did not obtain a benchmark cost of Fidelity’s services”.

# How to Determine that Plan Fees are “Reasonable”

## Benchmarking Plan Services and Costs

- ERISA requires that plan fiduciaries engage in a prudent process for selecting and monitoring services provided to their plan.
  - This requires a comparison of costs and value.
  - For assessing service providers, the DOL and courts have said that plan fiduciaries should obtain market data and evaluate plan costs and services in that context.
  - The most cost-effective approach to gathering comparative market data is through the use of benchmarking services that comply with ERISA requirements

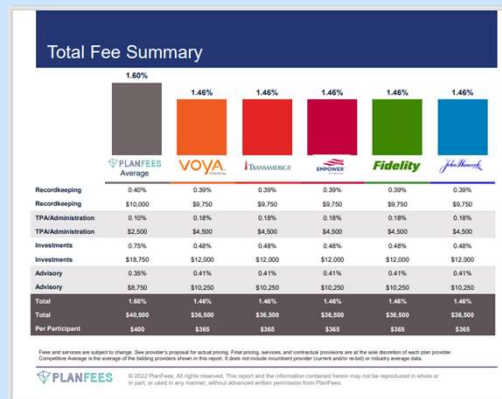
# RPAG Fee Benchmarking Suite



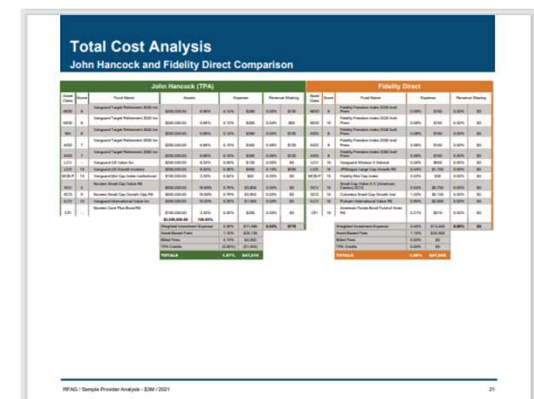
Innovative Annual Fee Benchmark



Streamlined Small Plan Proposals



Industry Leading Live-Bid System



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# DOL Proposes Rule Encouraging ESG

On October 14, 2021, the Department of Labor (the “DOL”) published a proposed regulation, *“Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights”*.

- The proposal follows the DOL’s announcement on March 10, 2021, that it was re-examining the regulations published by the Trump administration (the “2020 ESG Rule”).
- In the same announcement, the DOL stated that it would not enforce the 2020 ESG Rule.

# DOL Proposes Rule Encouraging ESG

## ESG Factors May Be a Permissible Consideration

- The Proposed Rule adds language to expressly state that, when considering projected returns on an investment, a fiduciary's duty of prudence *"may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action."*

# DOL Proposes Rule Encouraging ESG

## ESG Factors May Be a Permissible Consideration

- The purpose of this change is to make clear that ESG factors are risk-return factors that fiduciaries should consider in making investment decisions.
- However, the Proposal is clear that “a fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives” and may not sacrifice economic returns to promote ancillary goals.

# DOL Proposes Rule Encouraging ESG

## ESG Factors May Be a Permissible Consideration

- If a plan fiduciary selects a designated investment alternative (including a QDIA) for a participant-directed defined contribution plan on the basis of collateral benefits in a tie-breaker situation, the Proposal requires that the characteristics of the collateral benefits be “prominently” disclosed to plan participants.
- This is a significant change from the Current Rule, which prohibits the use of an investment alternative as a QDIA if the alternative reflects “non-pecuniary” factors in its investment strategy.

# DOL Proposes Rule Encouraging ESG

## ESG Factors May Be a Permissible Consideration

- *The Tie-Breaker Rule.*
  - The Proposal also sets forth guidance regarding “tie-breakers” pursuant to which a fiduciary may consider collateral benefits in selecting a plan investment if the fiduciary concludes that competing investments “equally serve the financial interests of the plan.”
  - The DOL notes that the investments don’t have to be “indistinguishable” for collateral benefits to be considered.
  - Instead, the fiduciary must conclude that the alternative investments are equally appropriate for the plan before deciding that collateral benefits can be considered in selecting one of the investments.

# RPAG ESG Ratings



# RPAG ESG Ratings

Final ESG Rating	ESG Rating	What it Means	
8.6* - 10.0	AAA	Leader	The companies that the fund invests in show strong and/or improving management of financially relevant environmental, social and governance issues. These companies may be more resilient to disruptions arising from ESG events.
7.1 - 8.6	AA		
5.7 - 7.1	A	Average	The fund invests in companies that show average management of ESG issues, or in a mix of companies with both above-average and below-average ESG risk management.
4.3 - 5.7	BBB		
2.9 - 4.3	BB		
1.4 - 2.9	B	Below Average	The fund is exposed to companies that do not demonstrate adequate management of the ESG risks that they face or show worsening management of these issues. These companies may be more vulnerable to disruptions arising from ESG events.
0.0 - 1.4	CCC		

Fund	Assets	Asset Class	Ticker/ID	ESG Quality Ratings			ESG Rating		Score
				Environment I	Social	Governance	Q4 2021	Q4 2021	Q4 2021
AB Large Cap Growth	\$5,124,456	LCG	APGZX	7.3	9	8.1	7.3	AA	10
Putnam Large Cap Value	\$4,876,424	LCV	PEQSX	6.9	7.3	7.7	7.2	AA	10
AB Small Cap Growth	\$1,478,123	SCG	QUAZX	5.5	6.9	4.3	4.9	BBB	10
American Century Small Cap Value	\$1,190,487	SCV	ASVDX	5.4	5.5	4.1	4.6	BBB	10
Fidelity International Capital Appreciation Fund	\$2,435,879	ILCG	FIVFX	8.5	5.4	8.8	8.7	AAA	10
PGIM Total Return	\$3,877,149	CFI	PTRQX	-	-	-	-	-	8



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# IRA Rollover Recommendations

## PTE 2020-02 requires:

The investment advice fiduciary must:

- Provide advice in accordance with the Impartial Conduct Standards (ICS).
- Acknowledge fiduciary status in writing.
  - DOL provided model fiduciary acknowledgement language as an example.
- Describe in writing the services to be provided.
- Describe in writing the material conflicts of interest (i.e., How you make money if your recommendation is accepted.)
- *Document the reasons that a rollover recommendation is in the best interest of the Retirement Investor and provide that documentation to the Retirement Investor.*



# IRA Rollover Recommendations

Is your rollover recommendation in your client's best interest?

Factors to consider.

- Can your client leave his/her money in the plan?
  - Generally, the answer is “yes”. Participant whose vested account balance exceeds \$5,000 can postpone distribution until later of NRA or age 62.
- Compare the range of investment alternatives available under the Plan and IRA.
- Compare the fees and expenses under the Plan and IRA.
  - Does the Employer pay all or some of the Plan fees and expenses?
  - If the IRA fees and expenses are more, what added benefits justify the higher costs?
- Compare the permitted forms of distribution under the Plan and IRA.
  - The Plan may limit the form of distribution to “single sum lump sum” only, while the IRA allows for periodic installments and partial withdrawals.
  - Consider the ability to tailor withdrawals to your client's particular income needs.
  - Compare the ability to take penalty-free withdrawals.
    - If your client terminates employment after age 55, payments received from the Plan are not subject to the early “pre-59 ½” distribution penalty.
    - The age 55 exception is not available to IRAs.
    - IRA distributions for first-time homebuyers and for qualified education expenses (distinguish from Education IRAs).

# IRA Rollover Recommendations

Is your rollover recommendation in your client's best interest?

Factors to consider.

- Roth conversions.
  - Does the Plan allow for conversion of non-Roth funds through an internal Roth-conversion?
- Application of the MRD (minimum required distribution) rules.
- Protection from creditors and legal judgments.
- Holding of Employer securities.

# RPAG Rollover Analyzer

- Easy to use Tool
- Integrates with RPAG Client Data
- If no data, can use 5500 integration with Larkspur
- If no fee data, can use integrations with PlanFees
- Oversight dashboard for compliance and review

### Rollover Analyzer

**Client Details**

Client Information	
Name	John Smith
Age	59
Current Account Balance	\$250,000
Employment Status	Employed
Employer Name	ABC Company
Household Net Worth	\$1,500,000
Objective	Rollover \$250,000 from employer sponsored retirement plan to an IRA.

Decision Factors	Importance	Weighting
All-in Fees and Expenses	High	20%
Available Investments	High	20%
Tax Considerations	Low	20%
RMD Considerations	Low	20%
Other Considerations	Low	20%

**Results**

	Importance	Current Plan	IRA	Result
<b>Fees and Expenses</b>	High	1.75% (\$5,146) <small>Based on Actual Plan Data Or Based on National Average</small>	1.00%	401(k)
<b>Available Investments</b>	High	Limited	Open Architecture	IRA
<b>Tax Considerations</b>	Low	High Benefit	High Benefit	Neutral
<b>RMD Considerations</b>	Low	Medium Benefit	Medium Benefit	Neutral
<b>Other Considerations</b>	Medium	Traditional 401(k) Plan Services	Investment Management, Estate Planning, Tax Planning, Insurance Planning, Retirement Income Planning, Distribution Planning	IRA

**John Smith Rollover Analyzer**

Rollover to IRA <span style="color: green;">✔</span>	Neutral	401K Plan
Cost Comparison	1.0% (\$2,500) <small>Current Plan</small>	0.57% (\$2,155) <small>IRA Investment</small>

**Disclaimer**

Investment Advisor

Investment Plan Statements

Investment Summary Material Modification

Investment Decision to Proceed

Investment Decision to Proceed

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# DOL Requests Proof of Fiduciary Training

- During recent DOL audits, the DOL has asked for documentation that the members of the plan fiduciary committee received fiduciary training over the past year.
  - Many plan sponsors have made a “best practice” of inviting an ERISA attorney to provide an overview.
  - However, the challenges remain in finding the budget and the time to schedule a meeting.
  - Independent fiduciary training is exactly what the DOL is looking for in documentation.

# Outlook for Retirement Plan Legislation in 2022

SECURE 2.0 – Bipartisan bills introduced in 2021 that are still in play.

- Passed House with overwhelming support – 415 yes, 5 no.

Key provisions likely to be included in a final bill:

- Permit 403b plans to invest in collective investment trusts (CITs)
- Permit employers to make matching contributions to plans (401(k), 403(b), SIMPLE) on behalf of employees who are repaying student loans
- Allow employees who work at least 500 hours in two consecutive 12-month periods to contribute to 401(k) plans

# Outlook for Retirement Plan Legislation in 2022

SECURE 2.0 – Bipartisan bills introduced in 2021 that are still in play.

- Automatic enrollment required for 401(k) and 403(b) plans
  - Initial enrollment – 3%, auto increase each year by 1% until it reaches 10%
  - Exceptions for small businesses (10 or fewer employees) and new businesses (less than 3 years in business)
- Higher catch-up limits to apply at age 62, 63 and 64
  - \$10,000 (SIMPLE plans \$5,000)
- Increase in age for MRDs
  - Age 73 starting 1/1/2023, Age 74 starting 1/1/2030, Age 75 starting 1/1/2033

# Outlook for Retirement Plan Legislation in 2022

SECURE 2.0 – Bipartisan bills introduced in 2021 that are still in play.

- Safe harbor correction for auto enrollment/increase plans
  - Correct without penalty before 9-1/2 months after end of plan year
- Separate application of top-heavy test to plans that cover “excludable employees”
  - Dual eligibility 401(k) plans

# Outlook for Retirement Plan Legislation in 2022

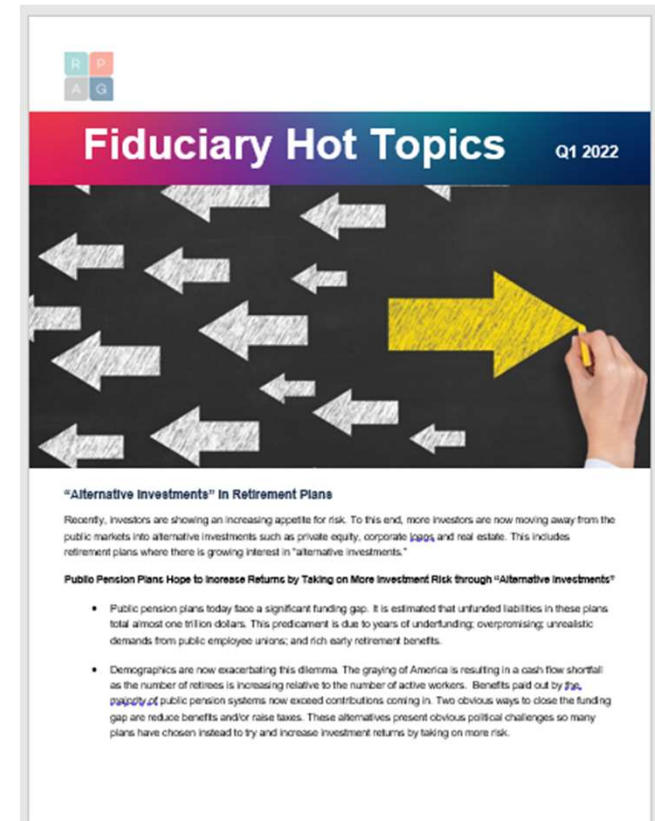
SECURE 2.0 – Bipartisan bills introduced in 2021 that are still in play.

- Revenue Provisions
  - SIMPLE IRAs allowed to accept Roth contributions
  - Employers may permit employees to treat employer SEP contributions as Roth (in whole or in part)
  - All catch up contributions will be subject to Roth tax treatment
  - Provide participants with the option of receiving employer matching contributions on a Roth basis



# RPAG ERISA Resources

- In-house, former practicing ERISA attorneys
- Regulatory and legislative updates
- Fiduciary Hot Topics Newsletters
- 20+ plan sponsor education modules
- On-demand client training videos
- Fiduciary Diagnostic roadmap
- Fiduciary Briefcase online vault system



## Action Items

Stay Up to  
Date on ERISA



Educate Your  
Clients



Review Your  
ERISA Support  
Resources

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