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## The Intelligent Fiduciary: Common Problems You Can Avoid

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## Are You a Fiduciary?

- You may be a fiduciary and not know it. Acknowledgement of fiduciary status is not required.
- A fiduciary has discretion or control over plan assets or administration, or gives investment advice for a fee
- Settlor v. fiduciary functions
  - Ministerial jobs do not trigger fiduciary liability-benefit calculations, tests
  - Geopharma case blurs the line
- If no other fiduciary is appointed, the plan sponsor and its Board members are default fiduciaries



We have the “two hats” approach, but under CDN law any function required for the administration of the plan attracts fiduciary liability, including benefit calculations

# Special Roles

- Trustee Responsibilities
  - Cannot be delegated
  - U.S. qualified plans cannot have Canadian trustees-domestic trust requirement
- Named Fiduciaries under ERISA
- Investment managers
- Third party administrators (TPAs)
- Board of Directors of Plan Sponsor always has residual fiduciary functions-can't outsource everything

TIP: Avoid problems. Know whether your TPA is a fiduciary.

## Who is a fiduciary under Canadian pension laws?

- No such concept as a “named fiduciary”
- The employer (or a “pension committee” in some jurisdictions ) is responsible for the administration of private sector plans
- As “administrator” employer is subject to fiduciary obligations
- “Two hats approach” has evolved to address potential conflict between the two roles – “administrator functions” attract fiduciary liability; “employer functions” do not.
- “Two hats” approach applies to employees, agents and advisors to the administrator - test is function they are performing (not their status under securities law).

## Are Your Vendors Fiduciaries?

- Investment adviser or broker? Tiblier v. Dlabal
  - This makes a BIG difference-brokers are subject only to suitability standard
  - Tiblier Court said adviser can't be a fiduciary unless paid by plan
  - The five part test for investment advice and possible changes
- 401(k) Vendors
  - Santomenno and Leimkuehler cases-not fiduciaries
  - Mass Mutual-can be fiduciaries

TIP: Avoid “Teflon fiduciaries.” Your investment adviser should acknowledge ERISA fiduciary status in writing.

## What about professional advisers?

- Lawyers, accountants and actuaries performing their usual roles are not fiduciaries. They may be advising plan sponsor in its settlor role.

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If vendor is giving advice, generally not a fiduciary; if vendor is carrying out a function assigned to the administrator it would be a fiduciary. Under Canadian law, case law has held that an actuary is an agent of the administrator and subject to fiduciary liability.

**TIP:** Avoid improper use of plan assets. If advising settlor, do not pay their fees out of plan assets.

## Basic Fiduciary Duties

- Prudent expert standard under ERISA
- Diversification (unless it's prudent not to do so)
- Avoiding prohibited transactions with related parties and self-dealing
- Follow plan terms
  - But what happens if plan pays the wrong amount?
- Operate plan solely in the interest of participants and beneficiaries
- “Safe Harbors” can protect fiduciaries
  - Participant- directed investments, default investments, selection of annuity providers
- Co-fiduciary and successor liability



No “safe harbors”.

TIP: Schedule a fiduciary education session.

## Fiduciary Duties Under Canadian Law

- Similar “prudent expert” test – administrator must retain experts if doesn’t have expertise
- The administrator is also subject to a “no conflict” rule.
- No comparable “safe harbors”.
- In addition to the overarching “prudent person” rule there are specific quantitative limits for pension investments:
  - 10% rule – diversification requirement
  - 30% rule – passive investor rule
  - Prohibition on related party transactions.



## Limits on Fiduciary Responsibility

- Only to the extent performing fiduciary functions
  - For example, a member of the Administrative Committee who is not on the Investment Committee is not responsible for investment decisions
- Personal liability only for losses connected to the breach of fiduciary duty
- Well-drafted plan documents and company charters can clearly define responsibilities and avoid overlapping functions
- BUT NOTE: Disclaimers will not work if you are acting as a fiduciary-functional definition

## Plan Committees

- Usually a Named Fiduciary under Section 402 of ERISA
- Board remains responsible only for prudent appointment and monitoring after full delegation
- Committees can be responsible for administration and/or investments
- Administrative committees are usually responsible for general compliance, including reporting and disclosure, non-discrimination testing, required amendments, claims review
- Investment committees are usually responsible for selecting managers or plan funds
- TIP: Make sure that your plan documents list the right fiduciaries

## The Best Committees

- Have a Charter or specific plan provisions establishing powers and duties
- Consist of members with specific competence: “A pure heart and an empty head are not enough”
- Understand how to review fees and share classes, and the importance of paying reasonable fees
- Make sure the right party is acting
- Hire the right professional advisers and have them present to report and answer questions at meetings
- Appropriately delegate to HR and Finance, but understanding that this does not remove committee responsibility

TIP: Special issues arise when parent and subsidiary share responsibilities.

## The Best Committees (cont.)

- Have an investment policy statement and follow it
  - Tussey v. ABB
- Meet regularly
- Leave the right paper trail
  - Agendas, formal minutes setting forth the reasons for decisions
- Establish internal controls

TIP: Schedule an ERISA governance review.



Investment policy statements are mandatory.

## Hiring Independent Fiduciaries

- Professional fiduciaries may be hired to represent plan participants where corporate officers would have a conflict of interest
- Typically hired when plans hold company stock
  - Purchase or tender offer
  - ESOP stock purchases
  - Determining when to eliminate stock fund
- NOTE: the U.S. Supreme Court recently held in Dudenhoeffer that ESOP stock investments are no longer subject to a presumption of prudence




No such thing as “independent fiduciaries”.

## Hiring Independent Fiduciaries (cont.)

- Used or required in some prohibited transaction exemptions
- Also have been used in de-risking transactions- annuity purchases
- May be used to decide whether plan should enter into settlement agreements
- Provides protection against agency action and participant lawsuits

TIP: Make sure to investigate fiduciary's qualifications and certifications.

## Fiduciary Liability Insurance

- Don't confuse it with the required ERISA bond or executive liability (D&O) insurance
  - ERISA bond provides recovery to plan if there is a loss due to fraud or embezzlement-won't reimburse fiduciaries
  - Fiduciaries should not rely on D&O insurance-typically does not cover acting as a fiduciary
  - Indemnification is not a good alternative
    - Plan assets may not be used to indemnify fiduciary for breach of duty
    - Employer indemnification may be limited by law or meaningless if employer in financial distress
-  No equivalent to an “ERISA bond”.

## Liability Insurance Issues

- Must be a third party claim
- Third party service providers will not be covered- not employees or directors
- May have to add a rider to cover committee
- What is wrongful act?
- Who picks counsel and how are defense costs handled?
- Are errors in administration covered?
  - Optional voluntary correction program coverage in absence of a claim
  - Are corrective benefit payments excluded?

TIP: Review your coverage with an expert.



## Activity to Monitor – United States

- Both the Department of Labor and the SEC are considering proposals to broaden fiduciary responsibility
- Controversial Department of Labor proposal (since withdrawn) would have eliminated part of five part test for investment advice
- Dodd Frank Act directed the SEC to consider one standard of liability for brokers and registered investment advisers
- We don't yet know when or whether they will act.
- Watch for U.S. Supreme Court decision in Tibble - will determine whether duty to monitor and review investments is limited to six years
- Watch for possible changes re: de-risking responsibilities

## Activity to Monitor - Canada

- Main changes are to the investment rules
  - New requirements for investments which will apply in most jurisdictions in Canada.
    - Changes to 10% rule; related party transactions (investments in employer stock not permitted except in certain limited circumstances)
    - Investment policies not required for DC plans.
  - New guidance for investment in derivatives. This will apply to plans registered in Ontario.
  - New requirement in Ontario to file the investment policy.
  - Investment policies in Ontario must state whether or not the administrator has considered ESG factors.
- In most Canadian jurisdictions, annual statements will need to be sent to former members and retirees.

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