



Fiduciary Training for Governmental Defined Contribution Plan Administrators

**East Bay Regional Park District
Board of Directors**
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Edward Bernard

Partner | San Francisco, CA
415.995.5807

ebarnard@hansonbridgett.com

AGENDA

- Overview
- Investments
- Service Providers
- Fiduciary Litigation
- Annual Review Process

OVERVIEW

- WHO is a Fiduciary?
- WHERE are the Fiduciary Standards?
- WHAT are the Fiduciary Standards?
- WHEN do the Fiduciary Standards Apply?
- WHY are the Fiduciary Standards Important?

Who is a Fiduciary?

- California Constitution Article XVI, §17 defines the fiduciary relationship of a “retirement board” and its members
 - Section (h) defines “retirement board” as:
 - “[T]he board of administration, board of trustees, board of directors, or other governing body or board of a public employees' pension or retirement system”
- The plan documents designate the fiduciary (either directly or by function) – e.g.:
 - 457(b) Plan: the employer (i.e., the Board) has authority to make all discretionary decisions affecting participant’s rights or benefits required in administering the plan
 - IPS: names the Board as the fiduciary responsible for administration and investments of the 457(b) Plan, 401(a) Plan and RHS Plan
- The Constitution describes the duties of those “governing” the system – refers not only to title but also function

Who is a Fiduciary?

- Under ERISA, a fiduciary is anyone who:
 - Exercises any discretionary authority or control respecting the management of the plan;
 - Exercises authority or control respecting management or disposition of plan assets;
 - Has any discretionary authority or responsibility in administering the plan; or
 - Renders investment advice for a fee (ERISA § 3(21))
- “Functional” test – title or position isn’t necessarily dispositive
- Note: ERISA does NOT apply to public sector plans, BUT:
 - ERISA and California fiduciary rules are similar
 - Courts may look to ERISA absent state-law guidance
 - Compliance with ERISA considered best practice in many areas

Who is a Fiduciary?

- Functions that indicate fiduciary status include:
 - Appointing other plan fiduciaries
 - Selecting and monitoring investments or service providers
 - Interpreting plan provisions
 - Deciding benefit claims or appeals
- Plans may permit the plan administrator or other fiduciaries to:
 - Delegate responsibilities to others (including service providers)
 - BUT delegation itself is a fiduciary act
- Plan or IPS may permit fiduciary to delegate certain duties to third parties, including:
 - Investment managers – make investment decisions and acknowledge fiduciary status, or
 - Investment advisors – recommend investment structure and guidelines (IPS) and help evaluate investment options

Who is a Fiduciary?

- Who are your other fiduciaries? You want to know...
- Under general common law, a fiduciary:
 - Must use reasonable care to prevent a co-fiduciary's breach
 - Breaches his or her duty by permitting a co-fiduciary's breach
 - Who learns of a co-fiduciary's breach must take reasonable steps to compel the co-fiduciary to cure the breach (Rest.3d Trusts, § 81)
- Similar provisions in ERISA § 405(a)

Where are the Fiduciary Standards?

- California Constitution Article XVI, §17
- Gov't Code § 53609: local agency deferred compensation plans are public pension or retirement systems under Article XVI, §17
- Gov't Code § 53216.6: this also applies to local agency pension plans
- If you're "governing" a plan providing retirement benefits for California public employees, you'll be held to these standards

What Are the Fiduciary Standards?

- California Constitution Article XVI, §17:
 - The governing body of a local agency deferred compensation plan has ***“plenary authority and fiduciary responsibility for investment of moneys and administration”*** of the plan, subject to:
 - three specific responsibilities and
 - three specific duties
 - “Plenary authority” means legal authority, but still subject to judicial review

What Are the Fiduciary Standards?

- Three specific responsibilities:
 1. Exercise sole and exclusive fiduciary responsibility over plan assets
 2. Exercise sole and exclusive responsibility to administer the plan in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries
 3. Hold plan assets for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan

What Are the Fiduciary Standards?

- Three specific duties:
 1. Duty of Loyalty
 2. Duty of Prudence
 3. Duty to Diversify

What Are the Fiduciary Standards?

- Duty of Loyalty
 - The Board must discharge its duties with respect to the plan solely in the interest of, and for the exclusive purposes of:
 - Providing benefits to participants and their beneficiaries,
 - Minimizing employer contributions, and
 - Defraying reasonable administrative expenses
 - The Board's duty to plan participants and their beneficiaries shall take precedence over any other duty

What Are the Fiduciary Standards?

- Duty of Prudence
 - The Board must discharge its duties with respect to the 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 these matters would use in the conduct of an enterprise of a like character and with like aims”
 - If you’re not an expert, you should rely on the advice of one
 - What the courts look for:
 - **Process is key!** If you use a strong and sound process to make prudent decisions, you reduce the risk of being challenged and can better support your decisions if you are
 - E.g., fiduciaries must engage in an objective, thorough, and analytical process that involves consideration of the quality of competing providers and investment products

What Are the Fiduciary Standards?

- Duty to Diversify
 - The Board “shall diversify the investments of the Plan so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so”
- ERISA adds the duty to discharge responsibilities in accord with written plan document (ERISA § 404(a))
 - 401(a) Plan: Compliance with written plan document is a tax-qualification requirement under Code section 401(a)
 - 457(b) Plan: A fiduciary must administer the trust diligently and in good faith according to the trust’s terms and applicable law. (Rest.3d Trusts, § 76(1))

What Are the Fiduciary Standards?

- In Summary
 - Act solely in the interest of participants and beneficiaries above all other duties
 - Hold and deal with plan assets exclusively to pay benefits and pay *reasonable* costs of plan administration
 - Act prudently with the care, skill, prudence and diligence that a *prudent person* familiar with such matters would use – a higher standard – not only reasonable, but also familiar, skilled
 - Diversify plan investments unless clearly imprudent
 - Follow the Plan's terms unless inconsistent with the law
 - Focus on process and documentation, not results

When do the Fiduciary Standards Apply?

- The fiduciary standards apply to fiduciary functions, including:
 - Selecting and monitoring investments and service providers
 - Interpreting Plan provisions
 - Deciding benefit claims or appeals
 - Delegation
- The fiduciary standards do not apply to “ministerial” functions
 - “Ministerial” – Not involving *discretionary* authority to administer the plan or manage its assets – e.g.:
 - Collecting & allocating contributions, applying eligibility rules, processing claims, preparing participant communications
 - One with no discretionary authority who performs administrative tasks within a framework made by others is not a fiduciary
 - Fiduciaries may rely on information provided by persons who perform ministerial functions if prudently selected

Why Are the Fiduciary Standards Important?

- Complying with the fiduciary standards avoids potential adverse consequences
 - Participant litigation
 - Claim for damages = loss resulting from breach
 - The number of lawsuits re fees and investment options under defined contributions plans continues to grow
 - State law may afford more flexibility in obtaining damages
 - Negative public and employee relations
 - Even unsuccessful lawsuits garner bad press and loss of participant trust in plan fiduciaries
 - Personal liability?
- Increases ability to demonstrate compliance in the event of IRS audit of internal controls
- Helps ensure best practices

INVESTMENTS

Fiduciary Decisions

- California Constitution Article XVI, §17:
 - The governing body of a local agency deferred compensation plan has sole and exclusive fiduciary responsibility over plan assets
- Functions to which the fiduciary standards apply include:
 - Developing and maintaining the investment policy statement
 - Selecting and monitoring investment options
 - Selecting the default investment option
 - Deciding when to remove an investment option that fails to satisfy the established criteria

Selecting and Monitoring Investment Options

- Fiduciaries must prudently select and monitor investments and diversify them unless imprudent in accord with the plan
 - Focus on process, not results—process must be flexible not static
 - Perform active oversight
 - Follow and review and update the investment policy statement
 - Document review and decision-making process
- Best practices for selecting investment options
 - Determine what investment purpose the option will fill
 - Use investment advisor to narrow options from which to choose
 - Evaluate candidates based on:
 - Performance, experience, size
 - Investment style and strategy
 - Fees – must be reasonable
 - Ask about enforcement actions, litigation and insurance

Selecting Investment Options

- Under the IPS, the Board will select investment options based on qualitative and quantitative factors
 - Qualitative factors include:
 - Compliance with contract, governing law, plan and IPS
 - Adherence to stated investment style and philosophy
 - Ownership stability and retention of key personnel
 - Any litigation or enforcement activities involving the manager
 - Information that may adversely impact performance
 - Quantitative factors measure performance at two levels: the investment option itself and underlying manager strategy
 - Investment options: review rates of return net of investment management fees and all fund expenses, including plan expenses
 - Manager strategy: review rates of return net of investment fees and fund direct fees compared to its benchmark and universe, but gross of plan expenses

Selecting Investment Options

- Consider other relevant factors such as:
 - Participant investment knowledge
 - Participant risk tolerance
 - Liquidity needs
 - Plan size

Selecting Investment Options

- Selecting a default investment option
 - Plan must provide how contributions will be invested if participant doesn't
 - Choosing this option is a fiduciary decision
 - DOL safe harbor for selecting a "QDIA" (29 CFR § 2550.404c-5): plan must:
 - Provide initial and annual notice to participants re QDIA and how to elect investments
 - Offer a broad range of investment alternatives under ERISA § 404(c) (probably want anyway for Gov't Code § 53213.5 relief)

Liability Relief – Participant-Directed Investments

- Gov't Code § 53213.5: fiduciary liability relief for participant-directed investments if plan meets ERISA § 404(c) – must provide participants opportunity to:
 - Exercise control over their account assets, and participants must actually exercise control
 - Choose how their account is invested from a broad range of investment options – must:
 - Have at least 3 options, each with materially different risk/return characteristics and diversified
 - Allow investment changes at least quarterly
 - Provide enough information re investment options to allow participants to make informed decisions

Self-Directed Brokerage Accounts

- Additional investment options may be available to participants through the self-directed brokerage account (SDBA) option
 - Participants investment options under SDBA are subject SDBA account provider's guidelines
 - Generally, participant elections under the SDBA aren't otherwise covered by the processes under the plan's IPS
 - However, fiduciary duties apply to selecting and monitoring the SDBA provider

Monitoring Investment Options

- Best practices for monitoring investment options
 - Follow the IPS
 - Review performance based on benchmarks (adjust as needed)
 - Review fees – confirm fees remain reasonable in amount and appropriate to investment needs of the plan
 - Determine if any conditions have changed that affect investment option appropriateness
 - Conduct periodic RFPs to learn about other qualified options
 - Document review and decision-making process and result

Monitoring Investment Options

- IPS: the Board will meet to monitor investment options periodically (at least annually) based on qualitative and quantitative factors
 - The IPS provides when the Board should put an investment option on a “watch list” based on its failure to meet standards
 - Once an option is on the watch list, the investment advisor performs additional analysis for subsequent Board review
 - Based on its review, the Board decides whether to keep the option, remove it from the watch list, or terminate it

SERVICE PROVIDERS

Selecting and Monitoring Service Providers

- ERISA: selecting and monitoring service providers is one of a plan fiduciary's most important responsibilities
- Plan fiduciaries are responsible for prudently selecting and monitoring all plan advisors, consultants, vendors, auditors
- RFPs: have a documented process – request and compare providers' financial condition & experience with similar plans
- Request information re recent litigation/enforcement action and fiduciary liability insurance
- Ensure contracts contain right to access all plan records needed to fulfill fiduciary duties, including ability to monitor
- Monitor service providers by periodically reviewing provider performance against plan benchmarks
- Ensure all providers' fees are fair and reasonable

OPERATIONS

Operations

- Fiduciary duties may apply to operational functions, such as:
 - Recordkeeping
 - Unforeseeable Emergency Distributions
 - Participant Loans
 - Processing Domestic Relations Orders
 - Claims and Appeals
 - Participant Communications
 - Data Security

Delegation

- You can't learn and perform every function under your supervision
- Delegate those duties and responsibilities the Board cannot properly perform
- Act prudently when choosing what to delegate and to whom
- Delegation does not relieve the Board from liability
 - Duty to monitor still applies

FIDUCIARY LITIGATION

Fiduciary Litigation – Breach of Fiduciary Duty

- Plaintiff must establish three elements:
 1. The existence of a fiduciary relationship – usually a question of law
 2. A breach of fiduciary duty – usually a question of fact
 3. Damage proximately caused by the breach – See, e.g., *Mendoza v. Cont. Sales Co.* (2006) 140 Cal.App.4th 1395, 1405.

Fiduciary Litigation – *O’Neal, et. al. v. Stanislaus County Employees Retirement Ass’n, et. al.* (2017) 8 Cal App 5th 1184

- Case involved a DB county retirement system, but still instructive how the court analyzed alleged breach of fiduciary duty
- In 2009, members sued StanCERA, alleging it breached its duty of loyalty by using a reserve fund to offset employer contributions and implementing an alleged negative amortization schedule
- Plaintiffs sought an order (1) prohibiting StanCERA from engaging in similar conduct, and (2) mandating that it collect additional funds from the County by special assessment
- The County intervened in the lawsuit and the court granted the County’s and StanCERA’s motion for summary judgment
- The ruling was overturned on appeal, but County and StanCERA ultimately prevailed in trial court on remand

Fiduciary Litigation – *O'Neal* (Continued)

- In discussing the relevant legal principles re breach of fiduciary duty, the appellate court looked to several sources
 - Statutory provisions in the '37 Act, which governs county retirement systems
 - California Constitution Article XVI, Section 17
 - The constitutional provision's legislative history
 - Cases interpreting the constitutional provisions
 - Law of trusts, including California Probate Code provisions

Fiduciary Litigation – Participant Fee Litigation

- The explosion of litigation over fees charged to defined contribution plan participants has only continued to grow
- Initially, the suits focused on ERISA-covered, large corporate 401(k) and other defined contributions plans
- Then plaintiffs' attorneys moved to suits against nonprofit, including university, 403(b) and other defined contribution plans
- Recently, we learned of a fee suit against a public sector DC plan so probably only a matter of time before we see more in this arena
- Frequently class actions claiming plan sponsor/administrator breach for selecting higher-cost funds when lower-cost ones available
- But also:
 - Claims for breach by 403(b) plan fiduciaries in offering complex investment lineups with costly, duplicative, poorly performing options
 - Suits against TPAs, claiming they became functional fiduciaries due to “consulting” regarding funds offered

Fiduciary Litigation – *Tibble v. Edison Int'l*, 135 S.Ct. 1823 (2015)

- Edison sponsored a 401(k) plan with a menu of investment options, including mutual funds
- Relying solely on its investment advisor's advice, Edison included three retail-class mutual funds in the plan menu (in 1999 and again in 2002), all three of which were, based on the plan's size, available in much cheaper institutional-class shares with virtually the same features
- 401(k) plan participants sued Edison, the plan sponsor, for
 - breach of fiduciary duty, challenging its investment selections, including retail-class mutual funds, as imprudent, and
 - revenue sharing as violating the plan document and a conflict of interest
- On appeal, the Ninth Circuit affirmed the District Court's ruling that, with one exception, the plan fiduciaries acted prudently

Fiduciary Litigation – *Tibble* (continued)

- The Ninth Circuit concluded that Edison –
 - Breached its fiduciary duty of prudence, not merely by including retail class mutual funds, but by not investigating the possibility of institutional class alternatives;
 - Unreasonably relied on its investment advisor's recommendation without reviewing the relative cost of all available share classes as an experienced investor would;
 - Couldn't prove that it considered institutional-class shares or the steps it took to evaluate investment advisor's recommendations; and
 - Wasn't relieved of its duty to prudently select and monitor investments by ERISA section 404(c), which limits a fiduciary's liability for losses that result from a participant's investment selection – the losses here were the result of Edison's decisions

Fiduciary Litigation – *Tibble* (continued)

- BUT the Ninth Circuit also agreed with the District Court that –
 - Claims as to three retail-class funds added in 1999 were time-barred
 - Initial selection starts ERISA's six-year limitations period running
- On appeal, the Supreme Court disagreed –
 - SOL based on continuing duty to monitor, not initial selection
 - Timely if continued breach of duty to monitor within 6 years of suit
- Lessons:
 - Easier to challenge high-cost funds in plan for all years
 - Ongoing duty to prudently monitor investments
 - Process, process, process!
 - Document, document, document!

Fiduciary Litigation – Be Prepared!

- Be prepared: Plaintiff's lawyers are going after large big \$\$\$ plans
- Act now to cut off future exposure
- Review areas targeted in lawsuits:
 - Poor investment choices (e.g. using more costly share classes or poorly performing funds)
 - Excessive investment fees (including not requesting and reviewing fee disclosures)
 - Failure to follow plan documents, including IPS
 - Excessive recordkeeping fees (no recent RFPs to justify)
 - Poor administration (e.g., late deposit of salary deferrals)
 - Inappropriate use of plan assets

Fiduciary Litigation – Fiduciary Insurance

- Do you have it now?
- Should you have it?
 - See Gov. Code § 22258—provides for a continuing legislative appropriation for funding fiduciary liability insurance for the CalSTRS board (including the defined contribution plans they offer)

ANNUAL REVIEW PROCESS

Plan Document Compliance

- ERISA fiduciary duties include complying with plan documents
 - 401(a) Plan: Operating plan in accord with plan document is a tax-qualification requirement under IRC § 401(a)
 - 457(b) Plan: A fiduciary must administer the trust diligently and in good faith according to trust's terms and applicable law. (Rest.3d Trusts, § 76(1))
- Best practices:
 - Familiarize yourself with plan terms
 - Document decisions re plan interpretation (regulations, policies, or procedures)
 - 401(a) Plan: Correct errors under IRS correction procedures (EPCRS) consistently and document
 - Review and update plan document on a regularly scheduled basis to reflect operations and incorporate required/discretionary state law or federal tax law changes

Plan Document Compliance

- Operational changes may need to be implemented prior to documents having to be updated
- 457(b) Plans also needs to be reviewed and updated for any required tax law changes to maintain its tax-favored status

Annual Review Process

- Review best practices and adopt those that are reasonable and appropriate for your plan
- Review vendor performance for year
- Review compliance with federal and state law requirements
- Review participant communications (including website updates) to ensure reasonable and appropriate
- Review with counsel any areas of risk or litigation exposure to be addressed

Overall Considerations for Managing Risk

- Ensure plan is operated in accordance with plan documents
- Engage in public, well-documented process demonstrating due diligence, transparency, and independent judgment
- Avoid conflicts of interest
- Obtain expert advice, but also ask questions
- Delegate suitable responsibilities to staff and others
- Monitor service providers
- Develop formal written policies and procedures and update them
- Attend meetings
- Purchase fiduciary liability insurance

Questions?

Thank you!