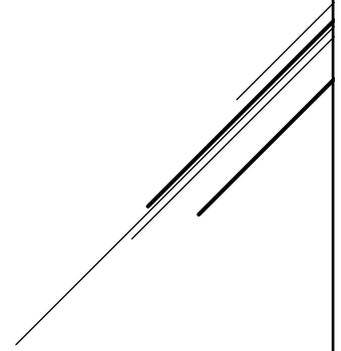


# The Pendulum Swings: Retooled Fiduciary Guidelines

David Schultz and S. Derrin Watson



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## Your Co-Hosts

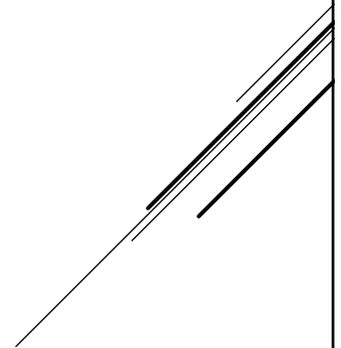
▶ Joanne Pecina



▶ Maureen Pesek



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David Schultz  
S. Derrin Watson

Your Presenters Today

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# ERISA Fiduciaries: Historical Overview

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## What is a Fiduciary

- A person who holds a legal or ethical relationship of trust with another party (or parties)
- Frequently used in the context of one person acting on behalf of another to manage assets or highly personal decisions
- A fiduciary has a legal and ethical duty to act in the best interests of the other party
  - As opposed to acting in the fiduciary's own best interests – or even in their joint interests
  - Fiduciaries must avoid conflicts of interest
- The concepts here come from ancient law and are not unique to ERISA
  - Think estate executors, guardians and wards, lawyers, corporate board members, and trustees

FIDUCIARY = TRUST  
(LOOK IT UP...)

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## Who's a Fiduciary Under ERISA?

- Under ERISA, a person is a plan fiduciary to the extent he or she:
  - (1) exercises any *discretionary* authority or *discretionary* control respecting plan *management*, or exercises *any* authority or control respecting plan *asset* management or disposition
  - (2) renders *investment advice* (respecting any plan money or other property) for a fee, or has any *authority* or *responsibility* to do so
  - (3) has any *discretionary* authority or *discretionary* responsibility in plan *administration*
- DOL issued (now defunct) regulations reinterpreting point (2)
  - The rules would have made many more (read: all) investment advisors fiduciaries under ERISA

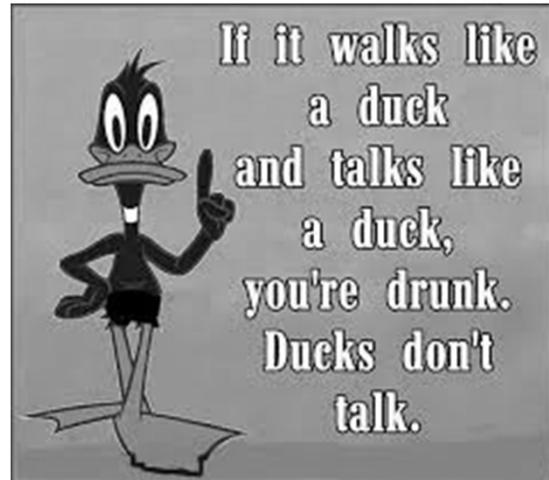
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## Who Is a Fiduciary?

- **Court cases say:**

- The fiduciary definition is intended to be broadly interpreted (i.e., if there is a doubt, someone will generally be found to be a fiduciary)
- The fiduciary definition is functional (i.e., if it walks like a duck, and talks like a duck, it's a duck)
  - This means, that if you take on fiduciary functions, you must act in a fiduciary capacity



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## Ministerial Duties That Do Not Make You a Fiduciary (DOL Reg §2509.75-8)

- Determining eligibility
- Calculation of service or comp for benefits
- Preparing communications
- Maintaining service and employment records
- Preparing reports for the company or the participants
- Preparing reports for government agencies
- Calculating benefits
- Explaining plan provisions and advising rights and options
- Collecting contributions and applying them
- Processing claims
- Making recommendations with respect to plan administration



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## Common Fiduciary Functions

- Selecting or delegating responsibilities to other plan fiduciaries
- Hiring or replacing plan service providers
- Negotiating fees with plan service providers
- Exercising discretion in approving or denying distribution and loan requests
- Determining eligibility for a hardship distribution
- Making discretionary amendments to the plan
- Signing and submitting the Form 5500 and other required government filings
- Managing or handling plan assets



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## Key Fiduciary Duties Under ERISA §404(a)

- A fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—
  1. For the **exclusive purpose** of: (i) **providing benefits to participants** and their beneficiaries; and (ii) **defraying reasonable expenses** of administering the plan;
  2. With the **care, skill, prudence, and diligence** under the circumstances then prevailing that a **prudent man** acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
  3. By **diversifying the investments** of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
  4. **In accordance with the documents** and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

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## Fiduciary Investment Advice

- **Fiduciary status is dependent on 5 factors:**

1. A person who **Renders advice** as to the purchase, sale or value of securities or other property
2. On a **regular basis**
3. Pursuant to a **mutual agreement**, arrangement or understanding, written or otherwise, between such person and the Plan or a Plan fiduciary
4. That the advice will serve as a **primary basis** for investment decisions with respect to plan assets, and
5. That the advice will be **individualized** to the particular needs of the Plan.



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## Prudence

- **ERISA fiduciaries are subject to the Prudent Expert Standard of Care**

- Act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims
- Requires more than simply a good faith effort to do the right thing
  - Get help if you are not an expert – OK to rely on advice/opinion of others
- It is about the process



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## Prudence

- **Requires a prudent process for making decisions**
  - But, if you don't document the process – it didn't happen...
- **Does not require that fiduciary always be right**
  - Example:
    - Trustee has investment discretion over plan assets
    - Trustee invests in a diversified portfolio focusing on equities
      - Careful review of the market
      - Considers risk, reward, and expense
      - Seeks counsel from reputable advisors
      - Periodically monitors plan investments
    - Market takes a sharp downward adjustment
    - **Fiduciary should not be liable so long as it can demonstrate the investment decisions were made prudently, with adequate diversification, and in accordance with plan policies**

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## TPAs as Fiduciaries: ERISA §3(16) Plan Administrators

- **TPAs are increasingly willing to take on certain fiduciary responsibilities:**
  - Can be named in the plan
  - Can take on the duties contractually
  - Can undertake the responsibilities and become a functional fiduciary



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## TPAs as Fiduciaries: ERISA §3(16) Plan Administrators

- **What fiduciary duties are you taking on?**
  - Fiduciary vs non-Fiduciary acts
  - Are you acting as an investment fiduciary?
  - Do you have discretionary authority (or are you exercising discretion)?
    - Is your discretionary authority limited in scope?
  - Are there duties you explicitly want to avoid (such as collecting deposits)?

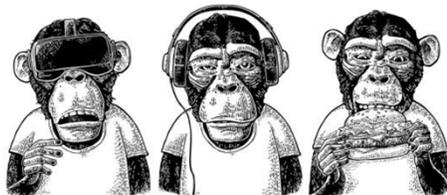
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## Co-Fiduciary Liability

- **If you are a fiduciary, you can be liable for a breach by another fiduciary if you:**
  - Participate knowingly in, or knowingly undertake to conceal, an act or omission of another fiduciary, knowing such act or omission is a breach of duties;
  - Enable a breach by another fiduciary; or
  - Fail to take reasonable steps to remedy a breach
- **If you are a 3(16) TPA or an investment fiduciary, and you know about a breach by your client, you may need to take action (other than resigning)!**



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# PROHIBITED TRANSACTIONS



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## Prohibited transaction rules

- **Designed to prevent plan fiduciaries from causing plan to engage in transactions which involve a possible conflict of interest**
  - Plan could get hurt by such transactions
  - Not required that plan suffer actual harm for transaction to be prohibited
- **Code §4975 and ERISA §408 contain PT rules**
  - Similar but not identical rules
  - Code addresses transactions with “disqualified persons” and ERISA with “parties in interest”
  - We’ll focus on tax rules

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## Who and what

- PT rules require identification of the plan's disqualified persons (WHO)
- Also must identify the transactions which are prohibited (WHAT)
  - Direct and indirect transactions are covered
  - Cannot escape using a “straw-person/entity”
- If transaction is prohibited, possible escape if exemption
- If not, and transaction goes ahead, the disqualified person must pay excise tax under §4975 and a plan fiduciary must “unwind the transaction”
  - Failure to unwind results in additional excise tax and possible fiduciary sanctions
  - Generally IRS will not disqualify the plan; is a tax/fiduciary issue

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## WHO (are disqualified persons)

- Plan fiduciaries
- Plan service providers
- Employer sponsoring the plan
- Employee representative (e.g., union) of EEs covered by plan
- 50% or more owner of employer or EE representative; attribution rules apply
- Family member (spouse, ancestor, lineal descendant and spouse of lineal descendant) of fiduciaries, service providers, employer, or 50% owner
- Corporation, partnership, trust or estate which is 50% or more owned by fiduciary, service provider, employer, employee organization or “50% owner”; attribution rules apply
- Officers, directors, 10% or more owners or HCEs (meaning earning 10% or more of annual wages paid by ER) of employer, employee organization, “50 owner” or “50% owned entity”
- 10% or more partners of employer, employee organization, “50 owner” or “50% owned entity”

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## WHAT (is prohibited)

- Sales, exchanges leases of property
- Loans or other extensions of credit
- Furnishing goods, services, facilities
- Transfer to, use by a disqualified person of plan assets or income
- Fiduciary self-dealing or “kickbacks”
  - Act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
  - Receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.



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## Prohibited transaction examples

- Each of these examples involves the ABC Co. 401(k) plan. Andy owns 60% of ABC.
  - ABC doesn't deposit elective deferrals in a timely manner
  - ABC plan loans \$100,000 to shareholder of DEF; DEF's plan loans \$100,000 to shareholder of ABC
  - Andy leases apartment in building that plan owns
  - ABC transfers mortgaged real estate to plan as profit sharing contribution
  - Plan pays trustee's wife (and an ABC employee) for services
  - Plan loans money to Andy's son-in-law (not participant)
  - Participant purchases a condo on the beach as an investment/rental, then stays in the condo (whether or not they pay for it)
  - Participant purchases artwork as an investment, and hangs it in her office
  - ABC contributes property to the plan in satisfaction of a funding **obligation**



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## PT correction

- **Undo the transaction to the extent possible**
  - Not put plan in worse position than if transaction did not occur, applying highest fiduciary standards
- **Correction depends on transaction type**
  - Rescind a sale, terminate a lease, pay-back a loan
- **Sometimes correction may result in another separate PT**
  - In some cases, DOL says these corrections are exempt

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## 3 types of PT exemptions

- **Statutory**
  - Code §4975 (and ERISA) grant relief
  - Address common transactions otherwise prohibited : participant loans, furnishing goods and services, transactions involving employer securities , etc.
- **Class**
  - Grant relief to a variety of transactions without having to apply for individual exemption; just meet the conditions
  - Many class exemptions relate to common financial industry transactions
- **Individual**
  - Apply to DOL in advance to seek relief
  - Must have conditions in place to protect plan

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## Excise tax calculation

- **Initial tax is 15% of “amount involved”**

- Applies to each year or partial year the transaction is in place; taxable year of the disqualified person
- “Amount involved” depends on transaction type
  - Sale: is greater of sale price or Fair Market Value (FMV)
  - Loan/lease: is greater of FMV interest or rent OR interest/rent paid
  - Late deferral deposit: fair market interest for use of the \$; use §6621(a) underpayment rate
- Continuing transactions (loans, leases) create new PT each year resulting in pyramiding of excise tax

- **100% tax on amount involved if PT uncorrected**

- Can abate 100% tax if correct within 90 days after IRS gives notice as to 100% tax; not reduce 15% tax

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## Excise tax and other reporting

- **Report and pay excise tax using IRS Form 5330**

- Due last day of 7<sup>th</sup> month following the disqualified person’s taxable year for which the tax is being paid
- Form 5558 extends time to file 5330 but not time to pay the excise tax

- **Also report PT on Form 5500**

- Schedules H, I, Form 5500-SF
- Schedule G, Part III for large plans

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## Fiduciary self-dealing

- Mike is a 10% owner in X, a CPA limited liability company (LLC)
- Mike and three of his fellow LLC owners are trustees of X's 401(k) plan
- Mike also has a securities license
- Mike sells investments to the plan and receives commissions in the amount of \$20,000
- Mike has engaged in a prohibited transaction
  - Correction is to return the \$20,000 to the plan and Mike files a Form 5330 and pays a \$3,000 excise tax

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## DOL FIDUCIARY REGULATION

Past, Present, and Future

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# Wait! The Reg is Dead. Why Talk About It Further?

- **The DOL is nothing if not persistent:**

- First attempt 2010
- Second attempt 2016
- Third attempt 2017
  - Struck down, 2018
- Fourth attempt 2020
  - Everything old is mostly new again

- **The court action “vacating” the new (2017) fiduciary rule restored the old the five-part test (1975) as the applicable standard**

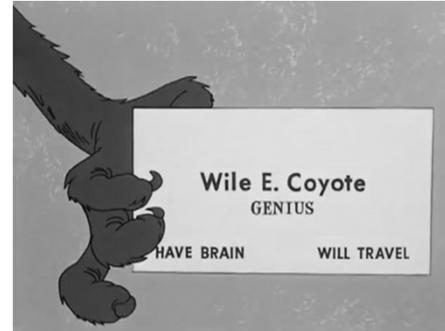
- But with some different interpretations (or so they say)

- **The SEC adopted Regulation BI (2019)**

- Creates non-fiduciary standard for brokers

- **The DOL proposed a new prohibited transaction exemption (2020)**

- Unlike the prior proposals, the new exemption does not attempt to change the definition of an investment advice fiduciary



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## Fiduciary Investment Advice – Swing and a Miss!

### Long-standing 5-Part Test

1. A person who **renders advice** as to the purchase, sale or value of securities or other property
2. On a **regular basis**
3. Pursuant to a **mutual agreement**, arrangement or understanding, written or otherwise, between such person and the Plan or a Plan fiduciary
4. That the advice will serve as a **primary basis** for investment decisions with respect to plan assets, and
5. That the advice will be **individualized** to the particular needs of the Plan.

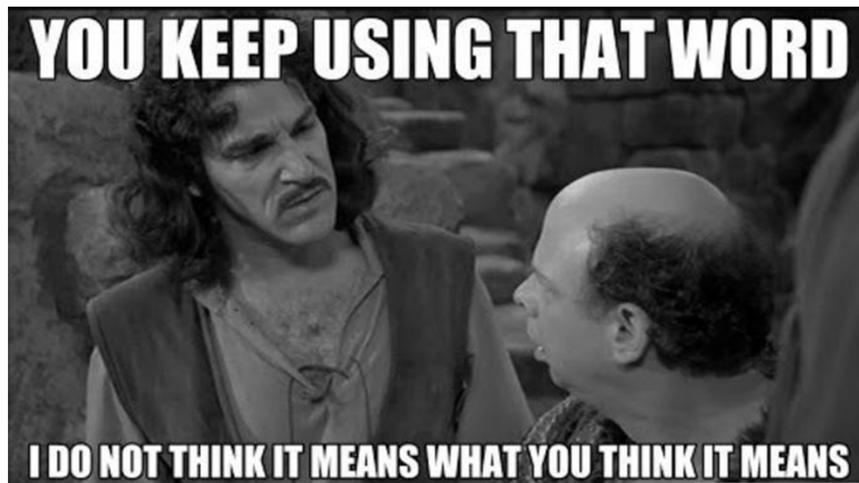
### DOL's “Stricken” Two-Part Test

1. A person who:
  - Represents or acknowledges fiduciary status, or
  - Renders individualized advice by making a recommendation pursuant to a written agreement or verbal understanding, or
  - Directs advice or recommendation to a specific recipient
2. Is **deemed to be a fiduciary** where such person makes a **recommendation** relating to
  - the **advisability** of acquiring, holding, disposing of, or exchanging, securities or other investment property, or invested after the securities or other investment property are rolled over, transferred, or distributed from the Plan, or
  - how investment property should be **invested** after it is rolled over, transferred or distributed from the Plan, or
  - the **management** of investment property, or
  - **rollovers, transfers, or distributions** from a Plan, including recommendations as to the amount, form or destination of such rollover.



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## What is a “Recommendation?”



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## Fiduciary Advice – Broadened Definition

- **The DOL's attempted to greatly expand the definition of fiduciary investment advice:**
  - To include participants receiving advice or recommendations
  - To include participants receiving advice regarding rollovers
  - To include one-time recommendations or advice
  - To include recommendations of investment professionals to give advice
  - To include non-individualized advice
  - To include advice by otherwise non-fiduciaries (such as TPAs), based on the type of advice
  - To include non-specific recommendations (such as a list of possible investments)
  - To include IRAs
- **The 5<sup>th</sup> Circuit Court of Appeals held that the DOL's reach exceeded their grasp**

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## 5<sup>th</sup> Circuit Killed Fiduciary Rule!

- **Chamber of Commerce, et al. v. U.S. Dept. of Labor**
  - 2-1 majority:
    - DOL reg directly contradicts statute and Congressional intent
    - Unreasonable interpretation of the law
    - The rule and PTEs are “vacated” – everywhere
- **This ruling effectively restored the old 5-part test as the fiduciary advice standard**



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## The SEC Speaks Up: Regulation BI

- **Regulation Best Interest (BI) was approved by the SEC in June 2019**
  - Compliance deadline: June 30, 2020
- **Creates a new, non-fiduciary market standard for brokers based on a quasi-fiduciary “best interest” standard of care**
  - Some of the concepts seem to have been inspired by the DOL’s (now revoked) Best Interest Contract Exemption
- **Applies only to “retail customers”**
  - A natural person (or legal representative) who
  - Receives a recommendation involving a securities transaction or investment strategy, and
  - Uses the recommendation primarily for personal, family, or household purposes
  - **Not directed at Plan sponsors, but can include advice on investment selection within a plan and/or rollover advice**

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## Regulation BI: Standards of Care/Requirements

- **Requires B/Ds to satisfy 4 component obligations:**

- **Disclosure** – must provide no later than the time of the recommendation written disclosure of all material facts related to scope and terms of relationship and any conflicts of interest
- **Care** – must exercise reasonable diligence, care, and skill to ensure that a recommendation to a retail customer is in the individual's best interest
  - Requires understanding and consideration of risks/rewards, costs, etc.
  - Must take reasonable steps to ensure recommendation does not put the interest of the B/D or broker ahead of the customer
- **Conflicts of Interest** – must maintain written policies designed to ID and disclose or mitigate conflicts of interest and the impact of financial incentives associated with the recommendation
- **Compliance** – must establish procedures reasonably designed to achieve compliance with Reg BI as a whole

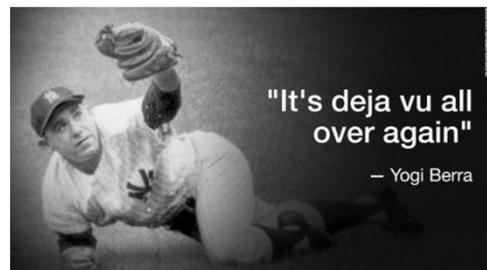
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## DOL: Forward to the Past

- **In July 2020, the DOL took steps to formally reinstate the 5-part test**
  - Reflects assumed status following the 5<sup>th</sup> Circuit's vacatur
- **The DOL also added commentary on its interpretation of the 5-part test**
  - Notably, DOL states that distribution/rollover advice could be fiduciary investment advice based on facts-and-circumstances
  - DOL explicitly disavows contrary position in Advisory Opinion 2005-23A (a/k/a "Deseret Letter")
- **DOL proposed a new prohibited transaction exemption**
  - Goal is to provide brokers with the flexibility to provide advice that impacts their compensation or engages in potential self-dealing (e.g., principal transactions)



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## Who is a Fiduciary: The New Old 5-Part Test

- **DOL recently stated that the Deseret Letter was an “incorrect analysis”**
- **In particular, the DOL has taken the position that IRA rollover advice may be a recommendation to liquidate or transfer plan assets to effectuate a rollover**
  - This means it could be covered by the 5-part test if part of an ongoing relationship
    - Key issue is the “regular basis” prong
  - Facts-and-circumstances determination
    - Was the participant previously provided investment advice?
    - Will there be post-rollover advice provided to the individual?
  - Determination of whether there is a “mutual agreement” that the advice will serve as a “primary basis” for investment decisions should be based on the **reasonable understanding** of the parties
    - If recommendation is based on the individual’s circumstances and/or consistent with Reg BI’s standard of care, the parties “typically should reasonably understand that the advice will serve as at least a primary basis for the investment decision.”



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## Proposed Exemption

- **Would permit investment advice fiduciaries to receive compensation as a result of providing otherwise conflicted advice to a plan fiduciary or participant**
  - Applies to RIAs, B/Ds, banks, insurance companies, and their employees/representatives
- **Requires investment advice to be provided consistent with the “impartial conduct standards” (i.e., the best interest standard), including:**
  - A duty of prudence and loyalty to not place the investment advice fiduciary’s (or their firm’s) interests ahead of the plan or participant’s
  - A reasonable compensation standard
  - A requirement to make no materially misleading statements
  - A disclosure of status as a fiduciary and conflicts of interest
  - Policies and procedures designed/maintained/updated to ensure compliance
- **Not intended to apply to those with discretion (3(38))**
- **Does not require a separate written contract and does not create new legal claims/rights beyond those provided for in ERISA**



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## The Good News

- **Relationships can go back to the way they were before (mostly)**
  - You can recommend advisors, they can recommend you, all is good in the world
- **But will they?**



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## The Status Quo?

- **Many financial institutions and broker-dealers have changed the way they do business, and may not necessarily go back to the way it was before**
  - Payments to ERISA accounts rather than TPAs
  - Payments only to those with investment licenses

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## The Rule Broadened Public Consciousness Regarding Plan Investments

- People are more aware of fiduciary vs. nonfiduciary roles
- More aware of fee concerns
- More aware of the right to sue for breaches



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## Picture This

- **You are a Plan Sponsor and a participant sues you for fiduciary breach, saying that the investments were bad...**
  - And, the plaintiff's lawyer asks you: "Why did you choose to hire a regular advisor who is not necessarily looking out for the participants instead of someone who is a fiduciary and owes a duty to the plan?"



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## You Have to Ask Yourself ...

- Even if recommending an investment advisor doesn't make me a fiduciary, can I recommend a nonfiduciary advisor to my client in good conscience?



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## Rollover Advice

- **Before the Rule was issued, many plan investment advisors may not have realized the fiduciary and PT implications of giving rollover advice**
  - Now, rollover advice is not automatically fiduciary advice, but it could be:
    - Five-part test
    - Investment advisor, and/or
    - Admit to fiduciary status



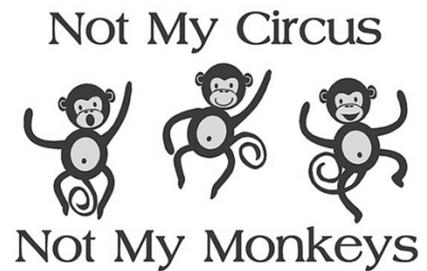
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## Do TPAs Care About Rollover Advice Problems?

- "Not my circus, not my monkeys."
- **But:**
  - TPAs want to make sure plans operate properly
  - TPAs want partners to be above-board
  - If you are a 3(16) Administrator, you may have greater concerns



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## Practical Recommendations

- **Talk to financial advisor who refer business about how they handle rollovers**
- **If you do 3(16) work, consider how to deal with potential co-fiduciary issues if the financial advisor gives rollover advice**

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## The Process Had Some Value

- **Despite the demise of the Fiduciary Reg --**
  - It helped focus attention on fiduciary oversight of plan investments
  - Plan investment education and information is not “free” and fiduciaries must evaluate the services provided and the cost
  - Alerted everyone to retirement plan issues



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## We Can All Use This Experience

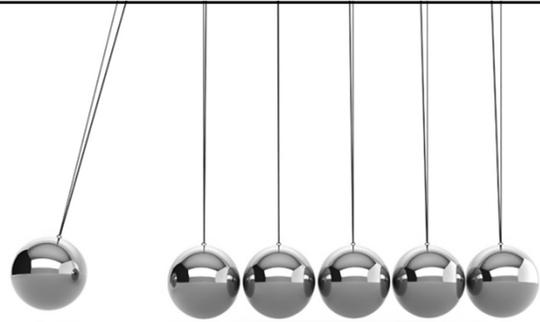


- **Help your clients:**
  - Figure out how to make sure that participants' interests are considered
  - Understand costs vs. service ... it's not all about the lowest cost provider!
  - Distinguish what you do vs everyone else and how to show your value proposition



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# ESG INVESTING

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Environmental

Social

Governance

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## Investment duties DOL Reg. 2550.404a-1

- **Act as prudent expert**
- **Duties are satisfied if fiduciary**
  - Has given appropriate consideration to those facts and circumstances that . . . the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in . . . the plan's investment portfolio . . . ; and
  - Has acted accordingly

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## Appropriate consideration factors

- **Appropriate consideration includes (but not limited to)**

- i. A determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio . . . , to further the purposes of the plan, taking into consideration the **risk** of loss and the opportunity for gain (or other **return**) associated . . . , and
- ii. Consideration of the following factors as they relate to such portion of the portfolio:
  - A. The composition of the portfolio with regard to **diversification**;
  - B. The **liquidity** and current return of the portfolio relative to the anticipated cash flow requirements of the plan; and
  - C. The projected **return** of the portfolio relative to the funding objectives of the plan.



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## What does that mean?



Look at the financial impact of an investment



Considering the portfolio as whole



With an eye to providing benefits for participants

And defraying reasonable plan expenses



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## Consistent with ERISA statutory fiduciary duties

- A fiduciary shall discharge his duties with respect to a plan **solely in the interest of the participants and beneficiaries** and—
  - A. for the **exclusive purpose** of:
    - i. providing benefits to participants and their beneficiaries; and
    - ii. defraying reasonable expenses of administering the plan;
  - B. with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
  - C. by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

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## History, Part 1

- **Clinton Administration**
  - Interpretive Bulletin 94-01
  - Dealt with “economically targeted investments” (ETIs)
    - What today we call ESG
- **“The Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.”**

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## 94-01 continues

- **There is an opportunity cost to an investment**
  - If you invest in something, you don't invest in something else
- **an investment will not be prudent if it would be expected:**
  - To provide lower return than alternative investments with similar risk, or
  - Is riskier than alternative investments with similar return



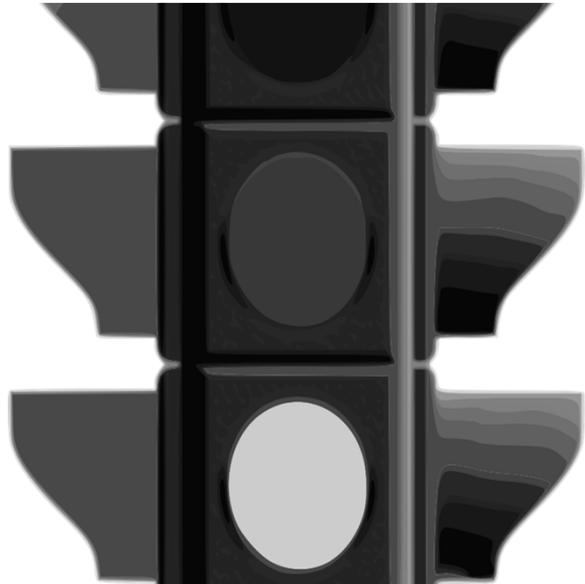
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## How does this apply to ESGs?

- **“The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally.”**
- **So you can invest in ESG if it's as good as comparable investments**
- **ESG is a “tie-breaker”**



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## History, Part 2

- **Bush Administration**
- **Interpretive Bulletin 2008-01**
  - Replaced IB 94-01
- **Fiduciaries may never subordinate the economic interests of the plan to unrelated objectives, and may not select investments on the basis of any factor outside the economic interest of the plan except in very limited circumstances enumerated below.**
- **Before selecting ESG, first conclude that alternative options are truly “equal”**
  - ERISA’s fiduciary standards , , , do not permit fiduciaries to select investments based on factors outside the economic interests of the plan until they have concluded, based on economic factors, that alternative investments are equal.
  - Prove it with written documentation



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## History Part 3

- **Obama Administration**
- **IB 2015-01**
  - Repealed IB 2008-01
- **Reinstated IB 94-01 word for word**



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## 2015 preamble

- In the seven years since its publication, IB 2008-01 has unduly discouraged fiduciaries from considering ETIs and ESG factors. In particular, the Department is concerned that the 2008 guidance may be dissuading fiduciaries from (1) pursuing investment strategies that consider environmental, social, and governance factors, even where they are used solely to evaluate the economic benefits of investments and identify economically superior investments, and (2) investing in ETIs even where economically equivalent. Some fiduciaries believe the 2008 guidance sets a higher but unclear standard of compliance for fiduciaries when they are considering ESG factors or ETI investments.



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## ESG can be relevant to economic impact Preamble continues

- **Environmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment.**
  - In these instances, such issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices.
- **Similarly, if a fiduciary prudently determines that an investment is appropriate based solely on economic considerations, including those that may derive from environmental, social and governance factors, the fiduciary may make the investment without regard to any collateral benefits the investment may also promote.**
  - Fiduciaries need not treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take into consideration environmental, social, or other such factors.



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## History Part 4 Not so fast

- **Field Assistance Bulletin 2018-01**
- **Fiduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision.**
  - It does not ineluctably follow from the fact that an investment promotes ESG factors, or that it arguably promotes positive general market trends or industry growth, that the investment is a prudent choice for retirement or other investors.
  - Rather, ERISA fiduciaries must always put first the economic interests of the plan in providing retirement benefits.
  - A fiduciary's evaluation of the economics of an investment should be focused on financial factors that have a material effect on the return and risk of an investment based on appropriate investment horizons consistent with the plan's articulated funding and investment objectives.

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## What about investment alternatives in participant-directed plan?

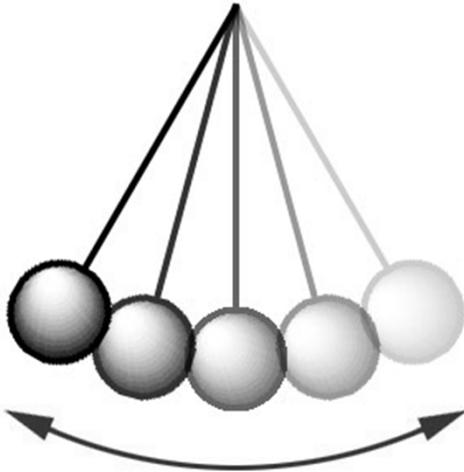
- **ERISA fiduciary standards apply to selection of designated investment alternatives**
  - “In the case of an investment platform that allows participants and beneficiaries an opportunity to choose from a broad range of investment alternatives, adding one or more funds to a platform in response to participant requests for an investment alternative that reflects their personal values does not necessarily result in the plan forgoing the placement of one or more other non-ESG themed investment alternatives on the platform”
- **Well-managed, properly diversified ESG-themed alternative can be added (other than as a QDIA), but:**
  - “A decision to designate an investment alternative may not be influenced by non-economic factors unless the investment ultimately chosen for the plan, when judged solely on the basis of its economic value, would be equal to or superior to alternative available investments.”

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## Back to the future DOL Proposed Reg 2550.404a-1



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- **Remove IB 2015-01**
- **“Notice and comment” regulation**
  - Entitled to greater deference by courts
  - Not as easy to change
  - Congress can veto (with President’s consent)
- **Comment period has expired**
- **Effective 60 days after final rule**

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## ESG Factors may be economic

- **Examples:**
  - Company improperly disposing of hazardous waste would be risky investment
  - Dysfunctional corporate governance impacts potential return
- **These should be considered as part of economic analysis**

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## **Don't go looking for ties**

### **Preamble**

- The Department expects that true ties rarely, if ever, occur.
- Seldom, however, will an ERISA fiduciary consider two investment funds, looking only at objective measures, and find
  - the same target risk-return profile or benchmark,
  - the same fee structure,
  - the same performance history,
  - same investment strategy,
  - but a different underlying asset composition.

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## **Restate and add to existing regulation**

- A fiduciary shall discharge that person's duties with respect to the plan solely in the interests 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, and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

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## Investment duties

- **Give appropriate consideration to relevant factors**
- **Evaluate “solely on pecuniary factors that have a material effect on the return and risk of an investment”**
  - Factor has a material effect on the risk/return
- **Not subordinate interest in retirement income/benefits to unrelated objectives**
  - Can’t sacrifice investment return or accept greater risk to promote goals unrelated to participant’s financial interests
- **Can’t subordinate the interests of participants to those of the fiduciary or others**



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## ESG Considerations

- **ESG considerations “are pecuniary factors only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories. The weight given to those factors should appropriately reflect a prudent assessment of their impact on risk and return.**
- **“Fiduciaries considering environmental, social, corporate governance, or other similarly oriented factors as pecuniary factors are also required to examine the level of diversification, degree of liquidity, and the potential risk-return in comparison with other available alternative investments that would play a similar role in their plans' portfolios.”**
- **If there is a true tie, document it and why ESG investment was chosen based on plan objectives**



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## Designated investment alternatives

- “A fiduciary's addition (for the platform) of one or more prudently selected, well managed, and properly diversified investment alternatives that include one or more environmental, social, corporate governance, or similarly oriented assessments or judgments in their investment mandates, or that include these parameters in the fund name” wouldn’t violate ERISA fiduciary standards if:
  - Use valid pecuniary criteria in making selection
  - Document selection
  - ESG mandate is not part of a QDIA



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## FIS Advanced Pension Conference - *Virtual*

Our three half-day **virtual Advanced Pension Conference** provides important updates on current legislative action and developments from the IRS, DOL and Capitol Hill, including the latest on the practical implications of the SECURE and CARES Acts. Offering a variety of topics presented by a panel of experts, conference attendees may earn up to **13 CE credits, including 1 Ethics credit.**

**Speakers:** Kevin Donovan, Ilene Ferenczy, Craig Hoffman, Dan McNamara, David Schultz, and Derrin Watson

**Event Dates:** September 1-3, 2020, 11 am – 4 pm EST each day

**Register here:** <http://www.cvent.com/d/6nqblh>



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## **FIS Cycle-Three Document Workshop PPD and Corbel - *Virtual***

The Cycle-Three restatement process has begun. Each virtual workshop provides a line-by-line review using the prototype-formatted pre-approved Defined Contribution Adoption Agreement, as well as a review of the basic plan document. **Each two half-day workshop offers 10 hours of CE credits.**

### **Cycle-Three Plan Document – Corbel – August 24-25, 2020**

11 am – 4 pm EST each day. **Register here:** <http://www.cvent.com/d/07qnm8>

### **Cycle-Three Document – PPD – August 26-27, 2020**

11 am – 4 pm EST each day. **Register now:** <http://www.cvent.com/d/77qnh>



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## **Questions?**



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