WILMINGTON TRUST

RETIREMENT PLAN INSIGHTS

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In this Issue

1 Should Fiduciaries Outsource Retirement Plan Investment Responsibility?

2 Should You Adopt a Plan Committee Charter?

4 Common Fiduciary Errors

3(38) Advisory Services — Should Fiduciaries Outsource Retirement Plan Investment Responsibility?

Department of Labor (DOL) enforcement recoveries are on the rise. A recent DOL report indicates that DOL recoveries have doubled since 2018 and tripled since 2016.* Private plaintiffs' ERISA-based lawsuit and settlement activity is similarly on the rise. Not surprisingly, fiduciary liability premiums have increased sharply, rising 35% since last year.**

> A recent DOL report indicates that DOL recoveries have doubled since 2018 and tripled since 2016.

Fiduciaries to plans are personally responsible for losses resulting from their fiduciary breach. Plan sponsor fiduciaries are responsible for selecting and monitoring plan investments in a prudent manner and for the exclusive purpose of providing benefits to participants and beneficiaries.

The Employee Retirement Income Security Act of 1974 (ERISA) fiduciary duty of prudence generally requires well-reasoned and informed decision-making. Where a fiduciary does not itself possess a sufficient level of expertise over a matter for which it is responsible, consultation with or delegation of decision-making responsibility to an outside expert may be appropriate. Plan sponsors and committees with fiduciary responsibility over plan investments frequently lack in-house investment

*www.investmentnews.com/dol-retirement-plan-recoveries-198660
**www.investmentnews.com/fiduciary-insurance-costs-401k-litigation-198407

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expertise (even where in-house investment expertise is present, those who have it may be unwilling to serve in a fiduciary capacity). Below, we discuss two approaches that plan sponsors and committees frequently use to better assure that ERISA's fiduciary responsibilities are satisfied in connection with plan investment decisions (investment menu structure, selecting and monitoring plan investment options).

ERISA 3(21) INVESTMENT ADVISOR

The most utilized approach is to engage an ERISA 3(21) investment advisor. An advisor acting in a 3(21) capacity is responsible for delivering prudent and loyal investment recommendations regarding the selection and ongoing monitoring of plan investments. DOL regulations make clear that it is the responsibility of the plan investment fiduciaries to understand the facts and circumstances that are relevant to a particular plan investment or investment course of action. Your Wilmington Trust retirement advisor is well positioned to assist with that understanding.

ERISA 3(38) INVESTMENT MANAGER

Section 402 of ERISA allows plan fiduciaries who are named or identified as such in the plan document or under a process specified by the plan document to delegate investment responsibilities. Such fiduciaries are frequently referred to as the plan's "named fiduciary." This named fiduciary may delegate the authority to acquire and manage plan investments to a 3(38) investment manager. Following the appointment of a 3(38) investment manager, the named fiduciary is shielded from fiduciary liability for the 3(38)'s day to day investment decisions, but retains responsibility for prudently monitoring the 3(38) investment manager's performance and fees. Typically, a 3(38) manager works with the client to develop an investment policy statement or similar guidelines to frame its investment management mandate, including guidelines on issues such as risk, expense, and style appropriateness.

Plan fiduciaries retain responsibility for prudently monitoring the 3(38) investment manager's performance and fees.

Should You Adopt a Plan Committee Charter?

Yes! A committee charter can be a helpful tool in demonstrating sound fiduciary governance practices. It is not dissimilar to how your Investment Policy Statement (IPS) can serve as a "roadmap" to the procedures used to select and monitor your plan investments. But as with an IPS, care must be taken. The provisions of the charter need to be drafted with care to make sure that they do not conflict with, and are consistent with, the governance provisions of the plan document. Similarly, the committee charter should avoid being overly prescriptive, as DOL sometimes alleges that a failure to follow IPS or charter procedures amounts to a fiduciary failure. Depending on the terms of the plan document, the charter may be a useful vehicle to document the process used by the plan sponsor to appoint the "named fiduciary" and/or delegations of fiduciary responsibilities from the named fiduciary to co-fiduciaries.

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A retirement plan governance committee charter ideally includes references to ERISA's core fiduciary principles, including the duty to manage the plan prudently and for the exclusive benefit of participants; adhering to the plan document; and ensuring proper diversification of investment options.

Committee members should sign the charter initially stating that they understand and accept responsibilities as a plan fiduciary and resign when retiring from the committee if they remain with your company.

WHAT IS A NAMED FIDUCIARY?

ERISA requires that plans be established and maintained pursuant to a written instrument which must provide for one or more named fiduciaries who have the authority to control and manage the operation of the plan and its investments. The plan's "named fiduciary" is the fiduciary named as such in the plan document or who is appointed by the plan sponsor pursuant to a procedure specified in the plan. This can be a specific individual, a committee, or most frequently, "the company" itself. "The company" as the named fiduciary would have the authority in the first instance to manage the plan's investments. For a "C Corporation" the company would typically exercise its fiduciary authority through its board of directors. Most plans permit the named fiduciary to designate others to carry out all or portions of its fiduciary responsibility. The board of directors, on behalf of a named fiduciary company, may choose to designate one or more individuals or a committee to perform its responsibilities. Where others are so designated, the board would retain a residual duty to prudently oversee and monitor the persons it has appointed. To assist the company in carrying out this monitoring function, an appointed committee typically reports back to the board (named fiduciary) periodically on its activities.

WHO, WHAT, WHEN AND WHY OF THE COMMITTEE

Given the high level of the committee's responsibility, it is important to staff the committee with individuals who are sufficiently knowledgeable and experienced to responsibly discharge the fiduciary function. It is also important that those individuals have sufficient time to devote appropriate attention to committee matters.

> All committee members should receive periodic training on their fiduciary responsibilities under ERISA.

The number of committee members varies, but one should consider having an uneven number of committee members to avoid any voting ties. Typically, medium, and larger plan committees will have 3, 5, or 7 members. Some plans will have a separate investment committee if investment knowledge is available in-house. It is important that committee members can make a contribution, and are agreeable to participating in committee activities.

Most medium and larger plan committees will meet with their plan advisor on a quarterly basis to discuss and document topics covered such as: investments, participant behavior/ retirement readiness, funding, administration, plan goals/objectives, plan administrative processes and general plan management.

It is expected that all committee members attend meetings regularly. Those that do not, or otherwise demonstrate a lack of commitment to their role, should be considered for potential removal and or replacement. If a member with specific expertise important to the plan leaves the committee, they need to be replaced by someone with the same expertise.

All committee topics and decisions should be thoroughly and carefully considered, in accordance with ERISA procedural prudence, and then documented in committee meeting minutes. If the decisions have an ongoing impact on the plan, those decisions should be reviewed periodically to ensure their continued prudence.

All committee members should receive periodic training on their fiduciary responsibilities under ERISA, their liabilities (and mitigation strategies), plan operations and plan administration. During an annual plan audit (required for plans with 100+

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participants) or a DOL investigation, it is typical for evidence of the frequency of fiduciary training for committee members be requested.

ERISA requires retirement plan fiduciaries to exercise their authority "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." This standard of "...a prudent person acting in a like capacity and familiar with such matter..." means having or obtaining expertise pertaining to each matter under consideration. As an example, when considering an investment decision, credentialed investment expertise is a best practice whether in-house or with a credentialed fiduciary plan investment advisor.

PERSONAL FINANCIAL FIDUCIARY LIABILITY MITIGATION

As a plan fiduciary you may become personally financially liable for any breach of duty that causes a loss to your plan. Retirement plans that operate without a coherent governance structure are susceptible to mismanagement, potentially incurring personal financial legal liability for imprudent or ill-informed decisions. There are effective strategies for mitigating this potential liability. Understanding your ERISA fiduciary responsibilities and liabilities clearly and administering your plan document accurately are most important. Obtaining ERISA fiduciary liability insurance and/or company indemnification should be considered.

As a plan fiduciary you may become personally financially liable for any breach of duty that causes a loss to your plan.

By creating an effective plan governance committee, including ongoing fiduciary education, your plan management can operate effectively for the benefit of plan fiduciaries and plan participants.

Common Fiduciary Errors

An ounce of prevention is worth a pound of cure. This saying is universal, and certainly applies to fiduciary responsibility. Beginning the year with an eye towards avoiding some of the most common errors makes sense.

Most fiduciary errors are unintentional or even well meaning. Here are some examples.

1. FOLLOWING PLAN DOCUMENTS AND COMMUNICATING CHANGES

The remittance of participant deferrals to the plan "on the earliest date on which [they] can be segregated from the employer's assets" means as soon as possible, not as soon as convenient. A common response when a plan administrator is asked how they determined applicability of a specific plan provision (e.g., eligibility for employer match) is "the prior administrator told me how to do it." This response does not necessarily instill confidence that it is being handled correctly. Many administrative errors go on for years and can give rise to an ongoing fiduciary breach. A common example is the management of plan forfeitures (non-vested assets left in plan by a terminated participant). The qualified plan rules require these assets to be allocated annually at year's end. Failure to do so can give rise to costly and administratively cumbersome corrections, but all too often this task is overlooked.

The definition of compensation in the plan document may not be the same definition used by your payroll department/service. Furthermore, many plans and employers have different naming conventions for the various money types: deferrals, employer match, bonuses, pre-tax health insurance premiums, FBA plan, commissions and tips, or fees for professional services may be included as compensation. When plan

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documents are changed or updated, compensation administration needs to follow. It is a good idea to check this periodically to ensure consistency.

Participant loans are another area that can cause issues, especially if more than one loan is allowed at a time or loan payback is allowed to continue post termination of service.

Unless due care is taken, plan operations may not align with the plan terms. This includes the terms in plan documents, the summary plan description, loan procedures, and the IPS.

Changes in the plan should be communicated to plan participants. A summary of material modifications should be given to plan participants within 210 days after the end of the plan year in which the modifications were adopted.

2. PARTICIPANT ELIGIBILITY

Plan documents should have a definition of employees (hours worked or elapsed time) and the requirement for eligibility to participate and employer contributions. The manner in which hours are calculated, hiring dates, or compensation calculations could be problematic. ERISA does not recognize the term "part-time employee." It strictly takes into consideration hours worked or elapsed time to determine eligibility for deferrals and employer match. In addition, the SECURE Act just created additional requirements in regard to long-term part-time employees' eligibility.

3. ERISA REPORTING AND RECORDKEEPING

Employers are required to maintain records relating to employee benefit plans per ERISA. Record maintenance varies by type of document for both plan level and participant level records. Plans with 100 participants or more must file Form 5500 Annual Returns/ Reports of Employee Benefit Plan and conduct an annual audit. Smaller plans must also file annual reports, with plans with less than 100 participants filing Form 5500-SF.

4. INVESTMENT POLICY STATEMENT

Where an IPS has been adopted, adhering to its prescribed procedures is of utmost importance. There have been successful lawsuits where an employer acted in the best interest of participants, but the IPS had requirements that the fiduciaries failed to follow to the letter and the result was costly to plan sponsors.

5. UNDERSTANDING AND DISCHARGING ERISA FIDUCIARY RESPONSIBILITIES

Many plan sponsors and fiduciaries are not fully aware of their roles and responsibilities. ERISA law pertaining to Defined Contribution (DC) plans is quite complex and sometimes unintuitive and unclear (What does "procedural prudence" really mean?). Plan sponsors should have a program in place to gauge the fiduciary health of the plan, know applicable fiduciary mitigation strategies, and to remedy, and hopefully avoid, fiduciary breaches.

6. CORRECTING ERISA COMPLIANCE MISTAKES

Many ERISA compliance problems can be corrected through voluntary compliance programs, when detected early by the plan, to reduce the potential for fines and penalties. The Department of Labor has the Delinquent Filer Voluntary Compliance Program (DFVCP) and the Voluntary Fiduciary Correction Program (VFCP). Through these programs, Plan Administrators can file delinquent annual reports through the DFVCP, and the VFCP allows fiduciaries to take corrective measures resulting from certain specified fiduciary violations for relief from enforcement actions. In addition, the Internal Revenue Service (IRS), through the Employee Plans Compliance Resolution System (EPCRS), has both the Voluntary Compliance Program (VCP) and Self Correction Program (SCP) which allow plan sponsors and other plan fiduciaries to correct failures in the plan's operational compliance prior to being discovered by the IRS.

The best answer to these concerns is to avoid fiduciary breaches. Financial professionals can often detect the possible emergence of potential fiduciary breaches before they manifest and consult on options to avoid these breaches altogether.

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Investments: • Are NOT FDIC-Insured • Have NO Bank Guarantee • May Lose Value

Source: Retirement Plan Advisory Group (RPAG)

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