COMPENSATION AND BENEFITS ALERT

Fall Fiduciary Update: Significant New Developments for Benefit Plan Fiduciaries

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Fall Fiduciary Update: Significant New Developments for Benefit Plan Fiduciaries

Because most benefit plans are structured as “calendar-year plans”, fall is traditionally the busiest season for plan fiduciaries who must deal with issues relating to annual enrollment (typically held in the fall) and comply with various year-end plan filing and employee notification requirements (such as annual notices dealing with automatic enrollment or default investment options). This fall, both the Department of Labor ("DOL") and the courts have issued significant new rulings and proposals that plan

OCTOBER 10, 2011

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Adverse Ruling in First Reported "Say On Pay" Decision fiduciaries should take time to consider:

1. **Fiduciary Liability for Failure to Affirmatively Provide Plan Documents – the Kunjanek decision.** Of most concern to plan fiduciaries may be a decision of the U.S. Court of Appeals for the Fifth Circuit, *Kujanek v. Houston Poly Bag* [1], which held a plan administrator liable for breach of fiduciary duty under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") for failing to produce plan documents even though the participant did not submit a written request for the documents. This case is significant because it equates a failure to produce plan documents by a plan administrator to a breach of fiduciary duty under ERISA and is particularly relevant to plan fiduciaries because ERISA provides that plan fiduciaries are *personally liable* for breaches of fiduciary duty. The relief awarded in this case against the plan fiduciaries appears to be well in excess of the statutory penalty of $110/day. (Orrick's ERISA Litigation Solution)

2. **Electronic Disclosure Guidance for Compliance with Participant Fee Disclosure Regulations.** Fiduciaries planning for compliance with next year's hotly anticipated plan participant fee disclosures will be interested in the DOL's recent guidance on electronic disclosure requirements under these participant disclosure regulations.

3. **Department of Labor Withdraws Controversial Regulation on Definition of Fiduciary.** Finally, fiduciaries concerned about last year's DOL controversial proposed regulations on the definition of "fiduciary" that would amend the definition of "investment advice" for purposes of creating fiduciary status under ERISA, discussed here, can rest easy (for now). The DOL has announced that it has withdrawn the current proposal and will re-propose the regulation in early 2012.

Fiduciary Liability for Failure to Provide Plan Documents – the *Kujanek* decision

In this case, despite a plan participant's failure to properly request plan documents under the plan's procedures, the Fifth Circuit held that a plan administrator was liable for breach of fiduciary duty for failing to produce the documents. The court held that the plan administrator's duty of loyalty under ERISA required it to provide the documents where it (a) knew Kujanek wanted the documents and (b) knew or should have known that Kujanek did not have the necessary information to request a rollover distribution from his profit sharing account.

ERISA's statutory disclosure regime requires plan administrators to provide plan documents to participants who make written requests within 30 days of the request or be personally liable to the participant for up to $110 per day in statutory penalties [2]. Plan administrators have typically expected that a failure on their part to provide documentation would be comprehensively governed by this regime, such that any penalties against them would be limited to $110 per day. Notwithstanding this expectation, courts are empowered to award "in [their] discretion such other relief as [they] deem proper" [3] and courts may fashion remedies for breaches of fiduciary duty where they find such breaches, regardless of whether the underlying facts may also support the finding of statutory penalties. ERISA holds plan fiduciaries personally liable to make whole a participant affected by a breach of fiduciary duty (although employers may purchase fiduciary liability insurance to protect plan fiduciaries). Therefore, a finding of breach of fiduciary duty may be quantitatively and qualitatively more significant for a plan fiduciary than an awarding of statutory penalties of $110 a day.

In *Kujanek,* the court held that the plan administrator's breach of its duty of loyalty to Kujanek entitled Kujanek to relief equating to the loss and depreciation in his profit-sharing account from 2007-2008, which loss and depreciation the court found could have been avoided had Kujanek been provided with the appropriate plan documents. Because of the financial crisis that spanned 2007 and 2008 and the corresponding record decline in the stock market, the losses that Kujanek's account suffered were likely particularly pronounced and more significant than $110 a day [4], making this decision very relevant for plan fiduciaries.

(Orrick's ERISA Litigation Solution)

Action Items for Plan Fiduciaries

The Kujanek decision should put plan fiduciaries on notice that failure to communicate plan documents and information to participants may constitute a breach of their duty of loyalty with the attendant liability. Upon request, plan fiduciaries are required to provide updated summary plan descriptions (“SPDs”), summary annual reports (“SARs”), and any “bargaining agreement, trust agreement, contract or other instrument under which the plan is established or operated.” [5] This last category includes formal plan documents and informal guidelines that affect the plan’s operation. Plan fiduciaries should also note that if they know that participants require this documentation, they are required to produce it as part of their fiduciary responsibilities *even if the participant does not properly request it*.

Therefore, it is important that plan fiduciaries implement a comprehensive system for effective communication with and disclosure to plan participants. The system should ensure that fiduciaries provide SPDs to new participants at the time of participation. For existing participants, fiduciaries should provide SPDs upon request (within the 30-day deadline) and SARs on an annual basis. Fiduciaries, particularly those responsible for investment matters, should make sure to provide benefit statements (with investment valuation information as required by ERISA) quarterly to 401(k) plan participants. Further, fiduciaries should be prepared to readily and promptly respond to a request for comprehensive plan documentation, and should have ready access to official, up-to-date formal plan documents and trust agreements. The system should also make sure that terminated participants (like Kujanek) are fully aware of their distribution and rollover options, by making sure information regarding those options is conveyed even if the participant does not request it. Fiduciaries may wish to consult with counsel to make certain that the system accounts for all required disclosures and deadlines in connection with claims and appeals procedures under the plan.

Electronic Disclosure Guidance for Compliance with Participant Fee Disclosure Regulations

The DOL recently released guidance permitting plan administrators to satisfy fiduciary requirements for fee disclosures concerning participant-directed individual account plans (such as 401(k) plans) through electronic media in certain circumstances. Technical Release 2011-13 provides for an interim policy on electronic media and is expected to be finalized before participant fee disclosures are required to be distributed next year.

Under the participant disclosure rules, plan fiduciaries are required to disclose comprehensive information relating to plan and investment costs and fees to participants in 401(k) and similar plans. Plan fiduciaries generally have until May 31, 2012 to provide this information. The DOL has provided Technical Release 2011-13 because it expects that plan fiduciaries will desire to provide this information electronically.

The DOL's previous guidance on electronic disclosure stated that plan fiduciaries could provide “pension benefit statements” electronically to:

(a) participants who are able to effectively access electronic documents at any location where the participant is reasonable expected to perform his or her duties and for whom access to the electronic information system is an integral part of his or her duties, and

(b) other participants who have affirmatively agreed to receive disclosures through electronic media.

Pension benefit statements are required to contain specific disclosure statements as well as statements as to the value of investments contained in a participant's account, and the vested status of a participant's account.

Under Technical Release 2011-13, disclosures required under the participant disclosure rules that are included in a pension benefit statement may be provided in the same manner that a pension benefit statement is furnished. For disclosures required under the participant disclosure rules that are *not* included in a pension benefit statement, the plan fiduciary may provide such disclosures electronically to the participants described in (a) and (b) above (the “Safe Harbor”), or, pending further guidance, may provide disclosures electronically in compliance with particular notification conditions. The administrator must:

- Provide an initial notice to the participant that includes certain information, including
  • a statement advising participants that providing their e-mail address to receive disclosures electronically is voluntary;
  • a description of the information that will be furnished electronically and how it can be accessed;
  • the availability of a paper copy;
  • the ability to opt out of electronic delivery at any time; and
  • the procedure for updating the e-mail address.
- Provide an annual notice that includes most of the same required information.
- Write all notices in a manner calculated to be understood by the average plan participant.
- Take appropriate measures to confirm that the information transmitted successfully.
- Take appropriate measures to protect the confidentiality of information transmitted electronically.

Since Technical Release 2011-13 provides interim guidance only, final guidance may vary, but we do not expect any changes to be significant. Plan fiduciaries should ascertain whether they are able to comply with the Safe Harbor set forth above with respect to disclosures not included in a pension benefit statement, and if not, prepare to comply with the DOL's notification conditions.

Department of Labor Withdraws Controversial Regulation on Definition of Fiduciary

As we indicated in October 2010, the DOL's proposed regulations substantially broadening the term "fiduciary" under ERISA regulations were fraught with controversy. The withdrawal of these proposed regulations was not unexpected.

The proposed regulation had promised to significantly broaden the definition of who is treated as fiduciary under ERISA by reason of providing "investment advice." Currently, the definition of investment advice is governed by a five-part test that had existed since 1974. The proposed regulation replaced this five-part test by a new test that made fiduciary status practically automatic for SEC-registered investment advisers in certain circumstances and caused considerable concern among plan sponsors and the financial community with respect to the regulation's co-ordination with other legislation, such as the Dodd-Frank Act. In particular, there was concern that the interaction between regulations issued under the Dodd-Frank Act and the proposed regulation would have the effect of prohibiting plans from entering into derivative contracts, including swaps (an important tool used by defined benefit plans to manage volatility), and bank-provided stable value contracts (an important tool used by defined contribution plans to offer a capital preservation investment option to plan participants).

Further, if the regulations had been finalized as proposed, plan sponsors were concerned that the service provider marketplace would shrink, since the broad definition could unnecessarily sweep certain service providers who do not have the business model to support fiduciary status into the category of fiduciary. Fiduciary status is costly, and requires compliance support and insurance. For example, most appraisers do not currently agree to fiduciary status. Appraisers who provide services to plans (for example, by appraising employer securities), would have had to revamp their business model at considerable cost in order to continue in business as fiduciaries. As well, for many consultants who do not provide investment advice under current rules, but recommend and assist with plan design, asset allocation, RFPs, manager retention and other consulting projects, fiduciary status and attendant potential liability would have meant substantial additional cost. If plan clients were not willing or able to pay additional fees, these service providers might have ceased doing business with plans. Further, for broker-dealers not engaged in providing investment advice under the current five-part test, fiduciary status would have meant considerable difficulty receiving fees and commissions from plans in connection with principal transactions, a key aspect of the broker-dealers' business model.

The proposed regulation received several hundred comments and the DOL held two days of hearings on it. Over the summer, several members of Congress, from both sides of the aisle sent letters to the DOL encouraging the DOL to reconsider certain aspects of it. Finally, on September 19, 2011, the DOL announced that it would withdraw the regulation and expected to re-propose it in "early 2012."

In its press release announcing the withdrawal, the DOL indicated that it would revise "provisions of the rule, including but not restricted to, clarifying that fiduciary advice is limited to individualized advice directed to specific parties, responding to concerns about the application of the regulation to routine appraisals and clarifying the limits of the rule's application to arm's length commercial transactions, such as swap transactions. Also anticipated are exemptions addressing concerns about the impact of the new regulation on the current fee practices of brokers and advisers, and clarifying the continued applicability of exemptions that have long been in existence that allow brokers to receive commissions in connection with mutual funds, stocks and insurance products."

These comments indicate that the DOL is aware of the concerns of plan sponsors with respect to swaps and stable value contracts, and will address these concerns in a re-proposed regulation. We expect that the DOL will provide that any re-proposed regulation is not intended to limit plans' access to swaps used to manage plan volatility and to stable value contracts. Further, while the comments in the DOL's press release may not entirely quell plan sponsors' concerns about the effect of a broad definition of "investment advice" on the service provider marketplace, the comments do indicate that any re-proposal will provide exemptions with respect to fees and commissions of brokers and advisers.

It is notable that the DOL has stated that it expects to re-propose the regulation in 2012, which is an election year. Election years can have the effect of delaying the proposal of controversial regulations; therefore we will continue to monitor closely the regulatory activity of the DOL.

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[1]--- F.3d ----, 2011 WL 4445993 (5th Cir.)
[2] ERISA Section 502(c).
[3] *Id.*
[4] During 2008, major U.S. equity indexes were sharply negative, with the S&P 500 Index losing 37.0 percent for the year, which translated into corresponding losses in 401(k) retirement plan assets. Source: Employee Benefits Research Institute, "The Impact of the Recent Financial Crisis on 401(k) Account Balances," EBRI Issue Brief #326, February 2009.
[5] ERISA Section 104(b)(4).