Trustee Ethics

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Overview Of Fiduciary Principles

• The fundamentals of ERISA fiduciary duties: **ERISA Section 404(a)(1)(A) sets out these rules:**

• **EXCLUSIVE PURPOSE:**
  
  – 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:
    
    • *Providing benefits to participants and their beneficiaries; and*
    
    • *Defraying reasonable expenses of administering the plan;*
Exclusive Purpose: ERISA Section 404(a)(1)(A)

- Fiduciaries must use fund monies for the EXCLUSIVE purpose of providing benefits for eligible individuals and defraying REASONABLE expenses of administering the plan.
Duty Of Prudence: Erisa Section 404(a)(1)(b)

- [A fiduciary shall 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 and with like aims;
Duty Of Prudence: Erisa Section 404(a)(1)(b)

- Fiduciaries must exercise the same PRUDENCE that an expert knowledgeable with the circumstances would use. And, if the Trustees are not experts, they need to hire one.
Diversification Of Investments: 
Erisa 404(a)(1)(c)

• Fiduciary shall protect [the Fund] 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.
Fiduciaries must diversify investments so as to minimize the risk of large losses. Besides “not putting your eggs in one basket,” this means that you, with your investment advisors, need to adopt an investment policy that allows for reasonable growth while protecting your portfolio on the downside.
Governing Documents: Erisa 404(a)(1)(d)

- [A fiduciary shall administer the plan] in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of [applicable provisions of ERISA].
Fiduciaries must follow the terms of the governing plan documents, assuming that these documents are in compliance with the applicable law.
Co-fiduciary Liability: Erisa Section 405(a)

- In addition to any liability which he may have under any other provisions of this part, a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:
Co-fiduciary Liability: Erisa Section 405(a)

- If he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;
- If, by his failure to comply with [ERISA Section 404(a)(1)] in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or
- If he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.
Co-fiduciary Liability: Erisa Section 405(a)

– Fiduciaries can’t let other fiduciaries get away with violations of their fiduciary duties.
Prohibited Transactions:
Part I: Erisa Section 406(a)

- A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—
  - Sale or exchange, or leasing, of any property between the plan and a party in interest;
  - Lending of money or other extension of credit between the plan and a party in interest;
Prohibited Transactions: Part I: Erisa Section 406(a)

- Furnishing of goods, services, or facilities between the plan and a party in interest;
- Transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or
- Acquisition, on behalf of the plan, of any employer security or employer real property in violation of [ERISA Section 407(a)].
Prohibited Transactions:
Part I: Erisa Section 406(a)

- Fiduciaries must not undertake any transaction between the fund and a “party in interest” that is in the best interest of the “party in interest.” A “party in interest” includes, among many others, any fund fiduciary, counsel, or fund employee; service providers for the fund; employees of employers covered by the plan; or any relatives of the same.
Prohibited Transactions:
Part II: Erisa Section 406(b)

• A fiduciary with respect to a plan shall not:
  – Deal with the assets of the plan in his own interest or for his own account,
  – In his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or
  – Receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.
Prohibited Transactions:
Part II: Erisa Section 406(b)

- Fiduciaries may not deal with plan assets for their OWN benefit or receive a personal benefit from someone doing business with the Fund. While ERISA allows a fiduciary to receive benefits for which he would otherwise be eligible under the rules of the Fund, a fiduciary cannot use his position to benefit either from the Fund or from a vendor doing business with the Fund.
Prohibited Transaction Exemptions: Part III: ERISA Section 408(b)(2)

- Under ERISA 406, a plan fiduciary ordinarily cannot use plan assets to pay for services. However, ERISA Section 408(b)(2) provides a limited exception to these rules, allowing the use of plan assets to pay fees for services. These exceptions apply ONLY where a fiduciary is “contracting or making reasonable arrangements” with the plan’s service provider for “services that are necessary” for plan operation, and only if no more than “reasonable compensation” is paid for them.
Prohibited Transaction Exemptions:
Part III: Erisa Section 408(b)(2)

The fact that there may be exceptions only means that there are exceptions, not that the rules on prohibited transactions don’t apply.
Personal Liability For Fiduciary Breach: Erisa Section 409

- Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of ERISA Section 411.
Personal Liability For Fiduciary Breach: Erisa Section 409

Any fiduciary who breaches any of the duties imposed upon fiduciaries by ERISA is personally liable to make good to the plan any losses caused by the breach as well as any other equitable or remedial relief may be ordered by a court.
DOL Penalty For Fiduciary Breach: Erisa Section 502(I)

- Civil penalties on violations by fiduciaries
  - In the case of—
    - Any breach of fiduciary responsibility under (or other violation of) part 4 of this subtitle by a fiduciary, or
    - Any knowing participation in such a breach or violation by any other person,

- The Secretary shall assess a civil penalty against such fiduciary or other person in an amount equal to 20 percent of the applicable recovery amount.
The DOL has discretion to waive or reduce this penalty on a finding that the fiduciary or other person acted reasonably and in good faith, or it is reasonable to expect that the fiduciary or other person will not be able to restore all losses to the plan without severe financial hardship unless such waiver or reduction is granted.
SCENARIO #1:

Mr. X is a high ranking official with large regional union. Mr. X is also a trustee of the multiemployer health & welfare and pension fund of which the regional union is a settlor. The regional union’s executive director, Mr. Big, is also a Trustee of the Fund.

Mr. X is dear chums with the Funds’ IT vendor, GrandY. Mr. X's girlfriend (his divorce isn’t yet final, of course), Miss Q, is an employee of GrandY. Miss Q has no health or pension benefits from GrandY.

Uh-oh – Miss Q gets very ill due to an intestinal parasite she picked up while vacationing in the Dominican Republic with Mr. X. Miss Q did not enroll in the Marketplace during one of the Open Enrollment periods and GrandY doesn’t pay enough for Miss Q to obtain unsubsidized coverage through a carrier. WHAT IS A BOYFRIEND TO DO?

Mr. X calls his chum, Mr. GrandY, and offers a very reasonable “collective bargaining agreement” that would – can you believe it? – cover only individuals in Miss Q’s position! And, because Mr. GrandY is such a good friend, the CBA would have VERY reasonable rates, in fact, lower than the rates offered to comparable employers. No cards are signed, no negotiations conducted, but a “CBA” is signed.

Mr. X submits the “CBA” to the Fund and recommends its acceptance by the Trustees with no explanation about the circumstances. On the basis of Mr. X’s recommendation, the Trustees accept the vendor as a contributing employer and provide health and pension benefits to members of the “bargaining unit” – that is, Miss Q. The other Trustees knew what was going on but, hey, they’re all friends there and it’s really no big deal. They “papered” the transaction, right? And, Mr. Big never informs the Executive Board of the regional union about Mr. X’s improprieties.

Let’s leave the fact that the “CBA” is a sham contract for others to deal with. Assume that you are also a Trustee on this Fund and you have just received a report from that humorless Boy Scout, i.e. Fund counsel, at a Trustees meeting.
QUESTION #1:

- Is the fact that Mr. X deliberately negotiated a contract with Mr. GrandY that benefits Miss Q and Mr. GrandY but not the Fund necessarily a breach of fiduciary duty?
  
  YES or NO?

- What if Mr. X was only a business agent but not a Trustee of the Fund? Still a breach of fiduciary duty to the Fund and its Participants?
  
  YES or NO?

QUESTION #2:

- Even if Mr. X had entered into a reasonable contract with Mr. GrandY, should that contract be subject to special scrutiny because Mr. GrandY is a party-in-interest as a vendor for the Fund?
  
  YES or NO?

QUESTION #3:

- This is a big fund, and say that Miss Q had only $300 in claims. Is there still a violation even though the harm is “de minimis” with respect to the Fund’s financial status?
  
  YES or NO?

QUESTION #4

None of the other Trustees participated in making this deal but they all knew that the deal was a sham contract with a party-in-interest and was advantageous for the vendor (and Miss Q) and not the plan. Do these fiduciaries bear the same kind of responsibility as Mr. X for these breaches of fiduciary duty?

YES or NO?
QUESTION #5: Does Mr. Big have to do more than have a “Dutch Uncle” talk with Mr. X?

YES or NO?
SCENARIO #2:

Trustees Al and Bob (one Union, one Employer) are two of eight Trustees of a large multiemployer pension plan. They have been delegated the task of working with the Fund’s administrator to review the responses to an RFP for pharmacy benefit managers (“PBM”). The firms bidding includes the incumbent, Rapacious PBM, and Vendors A, B and C.

Al, Bob and the Fund administrator have worked with Rapacious Drug, which had been the Fund’s PBM for several years. The Fund administrator recommended that the Trustees consider putting the pharmacy benefit out for bid because during the prior two years, the Fund had received an increasing number of complaints from Participants. The Fund administrator noted that the list of drug stores had shrunk, the mail order service made many errors – some very serious, and, finally, Rapacious had used a loophole in the contract to bill the Fund for generic drugs at the retail price, using what it called its “brand/generic algorithm,” causing the Fund to pay significantly more for certain medications than it had in prior years.

Al and Bob thought that Rapacious and its management had done a good job for the Fund. Rapacious cultivated the relationship over many years, including hosting “educational conferences” for Trustees at exclusive resorts that included opportunities for golf and deep sea fishing. Al and Bob had both received birthday and anniversary gifts of expensive bottles of wine and, one year, each received a set of new golf clubs. Nonetheless, they believed that they could be objective in evaluating the PBMs.

Following their internal Fund guidelines, the Trustees engaged Seagull Birdseye Experts (“SBE”) to administer the RFP process, including the analysis of the bids from the vendors. The SBE report showed that Vendors A, B, and C would all provide the Fund with lower prescription costs and dispensing fees than Rapacious, saving the Fund from 5% percent to 25% over what the Fund paid under the Rapacious contract.

Al and Bob were very surprised, as they had an overall positive view of Rapacious and doubted SBE’s conclusions. They decided to share SBE’s report with Rapacious, which they believed was only fair, so that Rapacious could respond. No other vendor was provided with the SBE report. Rapacious responded that SBE used the wrong formulas and had
overstated some of the pricing assumptions. Rapacious, however, did not provide specifics.

At the Trustees meeting, the administrator and SBE presented the report findings and recommended Vendor A, the PBM that would provide the Fund with the greatest savings and better service. Al and Bob, armed with the information from Rapacious, argued that SBE was wrong in its conclusions and that Rapacious should be renewed. The Trustees ultimately voted to disregard SBE’s report and the recommendation of the Fund’s administrator and to renew Rapacious’s contract with no changes.
QUESTION #1:

Did the Trustees commit any violation of ERISA by accepting the trips and gifts from Rapacious even when there was no issue about an RFP being issued?

YES or NO?

QUESTION #2:

Did the Trustees have an obligation to use an expert consulting firm to run the RFP process?

YES or NO?

QUESTION #3:

The Trustees have a good faith belief that Rapacious is doing a fine job, even though both the administrator of the Fund and the expert consultants concluded otherwise. Is it really a breach of fiduciary duty to ignore the experts’ report?

YES or NO?

QUESTION #4:

Does your answer change if Al and Bob are Trustees on a number of multiemployer plans and have extensive experience with Rapacious. Two of the other funds have also just done RFP’s in which Rapacious emerged as the leading candidate?

YES or NO?

QUESTION #5:

Did Al and Bob just do something shady or did they breach their fiduciary duties by sharing the SBE report with Rapacious? Did they commit a breach?

YES or NO?
QUESTION #5

Did the other Trustees breach their fiduciary duties by accepting the recommendation of Bob and Al rather than the recommendation of the experts?

YES or NO?
SCENARIO #3

Busy times in at the Professional Musicians and Exotic Dancers Association, Local 4! Several contracts across were up for renegotiation; the Pension Fund was teetering on yellow status; the Welfare Fund was drowning in costs for specialty drugs. Several of the Union officers and contributing Employers who also served on the Pension and Welfare Fund long planned on attending the annual IFEBP conference in Orlando, Florida.

This year, given the issues facing both the Pension and Welfare Funds, the Trustees were more interested than ever in attending in order both to hear the speakers and to have the chance to find out how other plans were dealing with these issues by speaking with other Trustees, professionals and vendors during the coffee breaks and in informal get-togethers.

Like most Funds, the PMEDA Funds provided Trustees with per diem advances and also limited reimbursement to those Trustees who submitted a certificate of completion showing that they attended at least 11 sessions at the conference.

The Funds Trustees included both Gene, the executive director of the Downtown Symphony and Larry, the Union business agent/ Fund Trustee responsible for the Downtown Symphony. Before they left for Orlando, they were well on their way to negotiating a contract extension. Shortly after they arrived, all hell broke loose back home, with the strings and woodwinds threatening to strike and the Symphony board threatening to lock them out.

Gene and Larry were constantly harried with phone calls from their respective bargaining principals, as well as the press and their own superiors. They attended as many of the classes as they could but were rarely able to complete a class before having to take a call crucial to the negotiations. As a consequence, neither received a certificate. They both did their best to buttonhole other trustees about the burning issues in their Funds and both enjoyed a little bit of time dining out with the other Trustees and visiting with old friends.

When they returned, they submitted their expenses to the Funds and were surprised that the administrator asked them to return the advances in full,
declined their reimbursement requests and demanded reimbursement the Funds for all amounts that they charged to Funds for travel and dining. Gene and Larry were shocked! They didn’t spend their time at the conference drinking in nearby bars or hanging out at Disney World, after all. They tried their very best to go to sessions and to learn from other trustees about the most important issues facing their Funds.

**QUESTION #1**

Is the Funds policy reasonable and appropriate? Does it subject the Trustees to unreasonable burdens?

*YES* or *NO*?

**QUESTION #2**

Notwithstanding the reasonableness of the Funds policies, couldn’t the Board waive the requirement here given that Gene and Larry had good reasons for not completing the required number of courses?

*YES* or *NO*?

**QUESTION #3**

Could the Funds make an exception if all of the Trustees, in recognition of the fact that Gene and Larry were not responsible for failing to get a certificate of completion, voted to make an exception to the policy?

*YES* or *NO*?

**QUESTION #4**

Doesn’t this result in a very unfair burden on these two men, who were just performing their “day” jobs?

*YES* or *NO*?
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