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Governmental Plans and the Impact of State Laws

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Lincoln Financial Group*

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Wayne McClain III, AVP and Senior Counsel Lincoln Financial Group

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Wayne McClain is Senior Counsel / AVP for Lincoln Financial Group focusing his practice on retirement benefit plans. He has a 20-year background in tax, ERISA and compliance aspects of qualified and non-qualified retirement plans with special emphasis on retirement plans for tax-exempt and governmental entities.

He has extensive experience in both the national law firm and national insurance company settings, including as Senior Counsel for several American International Group (AIG) companies, including The Variable Annuity Life Insurance Company (VALIC) and SunAmerica Financial Group.

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In addition to his experience as an employee benefits attorney, Mr. McClain has significant experience managing the administration and compliance of multi-billion dollar benefit plans in higher education. Mr. McClain was the Director of Benefits Plan Administration and Compliance for the University of Illinois and the University Director of Retirement Program Services for Indiana University. His experience in managing benefit plans for major state universities has given him a unique insight into the distinct needs of and challenges faced by tax-exempt and governmental plan sponsors in benefit plan administration and compliance.

Mr. McClain is a graduate of Indiana University, The Philadelphia Institute, and the Indiana University - Robert H. McKinney School of Law. Mr. McClain is currently pursuing an LL.M. in employee benefits from the John Marshall Law School in Chicago, Illinois.

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Are sponsors of governmental retirement plans fiduciaries?

Fiduciary duty for sponsors of governmental retirement plans generally may stem from a variety of state laws, including:

- State common law of trusts
- State common law of agency
- State statutes of enabling for retirement plans
- State statutes enacting ERISA standards
- State statutes enacting the Uniform Trust Code
- State statutes enacting the Uniform Prudent Investor Act
- State statutes enacting the Uniform Fiduciaries Act
- State statutes enacting the Uniform Commercial Code
- State statutes enacting prohibited transaction rules for retirement plans

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Common Law of Trusts and Fiduciary Duties

Retirement plan fiduciary concepts (including ERISA fiduciary rules) are generally based on the common law of trusts which has been codified into various codes and acts, including the Uniform Trust Code and Uniform Prudent Investor Act. These acts generally impose the following duties on trustees –

- Duty of Loyalty
- Duty of Prudence
- Duty of Impartiality
- Duty to Monitor and Diversify Assets
- Duty to Follow Terms of the Trust
- Duty to Keep Records, Provide Reports and Furnish Information to Trust Beneficiaries

Do these duties look familiar to you?

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Common Law of Trusts and Fiduciary Status

Under the common law of trusts and as codified in the Uniform Trust Code and Uniform Prudent Investor Act (among others), the trustee is the person who is entrusted with and responsible for holding and investing property on behalf of the beneficiary of the trust.

Responsibility is generally defined as exercising any discretionary authority or control with respect to the trust.

In a retirement plan, who is ultimately responsible for the plan?

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Common Law of Trusts and Fiduciary Liability

Under the common law of trusts and as codified in the Uniform Trust Code and similar acts, a breach of duty to a beneficiary invokes a court's equity powers to compel performance, suspend or remove the trustee.

Available damages include restoring a beneficiary's position as if breach had not occurred. The trustee's profit (if any) is also a measure of damage.

A trust instrument may not waive or vary the obligation of good faith or exculpate the trustee for reckless indifference. An exculpatory term in a trust is not enforceable if the inclusion of the term abuses the settlor's confidential relationship with the trustee.

Do these liabilities look familiar?

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A Word about Sovereign Immunity

Sovereign immunity was a nearly universal rule that held Federal, state and local governments immune from lawsuits or other legal actions for tort liability except when they consented to them.

Today, most states had waived sovereign immunity at both state and local government levels. Waiver initially came about through state supreme courts abolishing immunity via judicial decisions. More recently, states have abolished immunity via legislative measures. Today, most state and local governmental accept liability for torts committed by civil servants in the performance of government functions.

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General Fiduciary Best Practices for Governmental Plans

- Review state and local laws that may impose fiduciary duties with an experienced attorney.
- Confirm the identity of each plan fiduciary.
- Confirm each plan fiduciary understands their responsibilities as a fiduciary.
- Confirm that any employee acting as a fiduciary (including committee members) have received sufficient training to fulfill their fiduciary responsibilities.
- Confirm regular retirement committee meetings are being held and document the attendance of all plan fiduciaries, advisors, employee representatives, and service providers. Committee meetings should be conducted in a manner that ensures proper due diligence and facilitates informed decision-making by fiduciaries.

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General Fiduciary Best Practices for Governmental Plans

- Confirm that the plan has a fidelity bond and that the amount of the bond is at least 10% of plan assets.
- Evaluate the need for fiduciary liability insurance to protect the plan fiduciaries' personal assets against claims.
- Confirm and review contracts or agreements exist with all plan service providers outlining their responsibilities. For this purpose, many governmental plan sponsors are required to follow procurement rules.
- Monitor fiduciaries to ensure fiduciaries are acting solely in the interest of plan participants.
- Monitor service providers to ensure providers are executing their responsibilities in compliance the service provider contract or agreement.

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Fiduciary Duty to Follow Plan Terms – Governmental 457(b) Plan Case Study



- Confirm your organization is eligible to sponsor a governmental 457(b) plan, both from a federal tax code perspective and a state statute perspective.
- Confirm the signed plan document is current for all statutory and regulatory requirements, including state requirements.
- Create and maintain a fiduciary compliance file with all plan documents, trust agreements, service agreements, plan forms, investment policy statement, and related amendments.
- Confirm that the plan is being administered in accordance with the plan and trust documents.
- Confirm that the plan’s definition of “eligible employee” is consistent with the administration of the plan.

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Fiduciary Duty to Follow Plan Terms – Governmental 457(b) Plan Case Study



- Confirm that compensation is being calculated correctly (as defined in the plan document) and communicated to providers.
- Confirm plan contribution limits are being followed. For this purpose, the total amount of all contributions (including employee elective deferrals and employer contributions) made to the plan on behalf of the participant is limited \$18,000 in 2016.
- Confirm the 457(b) catch-up limitations are being followed. Generally, 457(b) plans can allow for two types of catch-up provisions. The first is the age 50 catch-up contributions for governmental employers only. The second catch up (the “special 457(b) catch-up”) is available to 457(b) plan participants who are within 3 years of normal retirement age. This catch-up feature can be equal to the annual contribution limit for the year (\$18,000 in 2015 and 2016) so the special 457(b) catch-up potentially can double this limit in a given year.

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- Review the plan’s process of collecting deferral contributions and loan payments and transmitting them to the plan’s trust in a timely manner.
- Auto enroll – Governmental plan contributions are subject to state wage & hour laws. Unless state statute specifically permits an auto enroll feature in the governmental plan, auto enroll would likely violate state wage & hour laws.

Some states permit auto enroll for the official state 457(b) plan, but not for 457(b) plans sponsored by local municipalities.

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Fiduciary Duty to Follow Plan Terms – Governmental 457(b) Plan Case Study

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- Confirm plan distribution restrictions are being applied. In general, a participant in a governmental 457(b) plan is eligible for a distribution if the participant has met one of the following events: attainment of age 70 ½; severance from employment; unforeseeable emergency; or death.
- Confirm unforeseeable emergency 457(b) plan distribution rules are being properly administered. Improper administration of unforeseeable emergency distributions is a frequent source of errors for 457(b) plan sponsors.
- Confirm the permissive service credit transfer rules are being followed.

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Fiduciary Duties regarding Plan Investments – Governmental 457(b) Plan Case Study



- Discuss pros and cons of assuming responsibility for selecting and monitoring plan investments with an experienced attorney. Historically, some states limited fiduciary exposure, provided the plan sponsor did not unreasonably limit employee access to the investments of their choice.
- Confirm that the plan has a formal process for selecting and monitoring its investments. Plan sponsors should consider using “procedural prudence” when selecting and maintaining investment funds for the plan. Procedural prudence refers to the fiduciary’s conduct in making the fiduciary decision (e.g., a decision to select a specific investment for the plan), not on its results. Procedural prudence requires a fiduciary to follow a careful, prudent and thorough process in order to make an informed evaluation and decision. Documentation of the decision making process is an essential component of procedural prudence.

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Fiduciary Duties regarding Plan Investments – Governmental 457(b) Plan Case Study

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- Confirm that the plan has a well-diversified investment lineup that includes options that span the risk/reward spectrum. As stated by the Department of Labor in Advisory Opinion 94-1, “In evaluating the plan portfolio, as well as portions of the portfolio, the fiduciary is required to examine the level of diversification, degree of liquidity, and the potential risk/return in comparison with available alternative investments. The same type of analysis must also be applied when choosing between investment alternatives. Potential investments should be compared to other investments that would fill a similar role in the portfolio with regard to diversification, liquidity, and risk/ return.”
- Consider the pros and cons of adopting and maintaining an investment policy statement (IPS) that can be provided to plan participants upon request.
- Confirm participants have been provided the contacts and resources they need to acquire plan investment information.

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Fiduciary Duties regarding Plan Investments – Governmental 457(b) Plan Case Study

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- Consider transferring investment asset allocation decisions to participants to potentially limit fiduciary liability. A plan may be able to give participants control over the investments in their accounts and limit a fiduciary's liability for the investment decisions made by the participants. For participants to have control, they generally must be given the opportunity to choose from a broad range of investment alternatives. For example, under ERISA, there must be at least three different investment options so that employees can diversify investments within an investment category, such as through a mutual fund, and diversify among the investment alternatives offered. In addition, participants must be given sufficient information to make informed decisions about the options offered under the plan. Participants also must generally be allowed to give investment instructions at least once a quarter, and perhaps more often if the investment option is volatile.
- Confirm all plan assets are held in trust for the exclusive benefit of participants.

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- Confirm sufficient information about investment options within the plan has been distributed to all participants and eligible employees.
- Confirm any restrictions on transferring to or from investment options have been clearly communicated to participants.
- Confirm the plan has properly notified employees when they become eligible for the plan and when they can take distributions from the plan.
- Confirm that a document file is maintained and contains copies of all communications with plan participants.

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Thank you

Thank you for your time and participation today.



Wayne McClain III, J.D.

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The logo for the NAFE 2016 NIPA Annual Forum & Expo. The word 'NAFE' is in large, multi-colored letters (red, green, blue). To its right, '2016 NIPA ANNUAL FORUM & EXPO' is written in smaller, black, sans-serif capital letters.

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The logo for the National Institute of Pension Administrators (NIPA). It features a stylized blue 'n' icon followed by the lowercase letters 'nipa' in a blue, sans-serif font. Below 'nipa' is the full name 'National Institute of Pension Administrators' in a very small font.

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