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A primer on ERISA's fiduciary structure

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Agenda

- Historical evolution of the “fiduciary” concept
- “Fiduciary” defined; fiduciary duties, prohibited transactions
- Roles of the employer
- The named fiduciary position
- The trustee position
- The administrator position
- The fiduciary investment adviser position
- The fiduciary investment manager position
- Plan operation – fiduciary considerations
- DOL Q&A on fiduciary responsibility

Historical roots of the “fiduciary” concept

- A fiduciary is a person who holds a legal or ethical relationship of trust with one or more other parties/persons
- “Fiduciary” concept dates back to the English common law
- ERISA takes the legal principles underpinning the fiduciary concept and creates a set of statutory obligations

ERISA's definition of "fiduciary"

- ERISA sec. 3(21)(A) defines a "fiduciary" as anyone who –
 - (i) exercises any discretionary authority or control respecting the management of the plan or management or disposition of plan assets
 - (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to plan assets
 - (iii) has any discretionary authority or responsibility in the administration of the plan
- Fiduciary positions –
 - Named fiduciary – ERISA sec. 402(a)
 - Administrator – ERISA sec. 3(21)(A)(iii) and 3(16)
 - Trustee – ERISA sec. 3(21)(A)(i) and 403(a)
 - Investment adviser – ERISA sec. 3(21)(A)(ii)
 - Investment manager – ERISA sec. 3(21)(A)(i) and 3(38)
- Formal designation not required for fiduciary status; functional

Affirmative duties of an ERISA fiduciary

- ERISA sec. 404(a)(1) states that a fiduciary must discharge his/her duties solely in the interest of plan participants and beneficiaries –
 - for the exclusive purpose of providing benefits and defraying reasonable expenses of plan administration
 - with the care, skill, prudence, and diligence of a prudent person in similar circumstances
 - by diversifying investments so as to minimize risk of large losses (exception for ESOPs)
 - in accordance with the terms of the plan and related documents
- ERISA sec. 404(b) requires that plan fiduciaries maintain all indicia of ownership of plan assets in the jurisdiction of U.S. District Courts

ERISA prohibited transactions – in general

- Two general types of prohibited transactions (“PTs”) -
 - Party in interest
 - Fiduciary
- Statutory and administrative exemptions available for party in interest PTs
- No statutory exemptions available for fiduciary PTs; only administrative exemptions
- Parties in interest include –
 - any fiduciary
 - a person providing services to the plan
 - any employer whose employees are covered under the plan
 - an employee organization whose members are covered
 - a 50% or more owner
 - certain relatives of individual parties in interest
 - certain corporations, partnerships, trusts

ERISA party in interest prohibited transactions

- ERISA sec. 406(a)(1) provides that, except as provided in ERISA sec. 408 (statutory exemptions), no plan fiduciary shall cause a plan to engage in a transaction, if such transaction constitutes a direct or indirect –
 - sale, exchange, or leasing of property between the plan and a party in interest
 - lending of money or other extension of credit between a plan and a party in interest
 - furnishing of goods, services, or facilities between a 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
 - acquisition, on behalf of the plan, of any employer securities or real property in violation of ERISA sec. 407(a)

ERISA fiduciary prohibited transactions

- ERISA sec. 406(b) prohibits a fiduciary from –
 - dealing with the assets of the plan in his or her own interest or for his or her own account (self-dealing)
 - in his or her individual or any other capacity, acting in a transaction involving the plan on behalf of a party whose interests are adverse to the plan and its participants (dual loyalties)
 - receiving any consideration for his or her personal account from any party in connection with a transaction involving plan assets (anti-kickback)
- Fiduciary investment advisers may not receive compensation that –
 - varies based on their investment recommendations (self-dealing)
 - comes from third parties (kick-back)
- No statutory exemptions for fiduciary prohibited transaction

Prohibited transaction penalties

- Financial penalty
 - Excise tax equal to 15% of the amount involved
 - Increases to 100% of the amount involved if the prohibited transaction is not corrected within the taxable period
- ERISA liability for a fiduciary breach
 - 409(a) – personal liability
 - 501 – willful violation could result in fines and imprisonment
 - 502(a) – lawsuits by DOL and participants to enforce ERISA and the terms of the plan
 - 502(l) – 20% penalty on the “applicable recovery amount”
 - 502(i) – administrative civil penalty
- Correction programs –
 - DOL – VFCP
 - IRS - EPCRS

Statutory exemptions to PT rules

- ERISA sec. 408(b) contains statutory exemptions to the PT rules for party in interest prohibited transactions
- (2) exemption for necessary services, provided no more than reasonable compensation is paid
- (14) permits investment advice to participants in plans if the conditions of 408(g) eligible investment advice arrangement are met
- (17) allows the following transactions between a plan and a party in interest who is not a fiduciary –
 - sale, exchange, or leasing of property
 - lending of money or other extension of credit
 - transfer to, or use by or for the benefit of, a PII of plan assets

Roles of the employer

- Employer's nonfiduciary role of plan sponsor
 - General business decisions
 - Settlor functions relating to the formation, design, and termination of plans, but not the management or administration thereof
- Employer's possible fiduciary role(s)
 - Named fiduciary
 - Functional fiduciary
- Examples of activities that make the employer a functional fiduciary –
 - Exercising control over a named fiduciary
 - Appointment of other fiduciaries
 - Failure to make a required plan contribution

The named fiduciary position

- ERISA sec. 402(a) – every plan must be established and maintained pursuant to a written document and provide for one or more named fiduciaries who have authority to control and manage operation and administration of the plan
- Plan document provisions for named fiduciaries –
 - Employer
 - Administrator
 - Trustee
 - Investment manager
- Employer, operating as a named fiduciary (not as plan sponsor), has authority to appoint and supervise the administrator and trustee and to formulate the plan's funding policy and method

The fiduciary investment adviser position

- ERISA sec. 3(21)(A)(ii) – a person who provides investment advice for a fee, direct or indirect, is a fiduciary of the affected plan
- No specific qualifications under ERISA for someone to act as an investment advice fiduciary
 - This is in contrast to the fiduciary investment manager position
- Subject to appointment and supervision by the trustee or other named fiduciary

Regulatory definition of investment advice fiduciary

- 2016 fiduciary rule was vacated by the Fifth Circuit Court of Appeals decision in *Chamber of Commerce of the United States of America. v. United States Department of Labor*
- Five-part test of 1975 regulations now applicable to determine status as an investment advice fiduciary
- Field Assistance Bulletin 2018-02 provides interim guidance until new regulations are issued
- Impartial conduct standards apply until new guidance issued
 - Provide investment advice in the best interest of the client
 - Investment advice provider receives no more than reasonable compensation
 - Investment advice provider makes no misleading statements

The fiduciary investment manager position

- ERISA secs. 3(21)(A)(i) and 3(38) – power to acquire, manage, or dispose of plan assets subject to the terms of the appointment by trustee or other named fiduciary
- Alternative qualification requirements –
 - Registered investment adviser
 - Bank or trust company
 - Insurance company
- Trustee or named fiduciary that appoints the investment manager is responsible to monitor the manager's activities, but is not responsible for the manager's investment decisions

Plan operation – fiduciary considerations

- Participant direction of investments in defined contribution plans – ERISA sec. 404(c)
 - Individual account plan
 - Participant has an opportunity to exercise control over the account
 - Participant can choose from broad range of investments
- The 404(c) regulations are optional from a compliance standpoint, but they allow fiduciaries to transfer liability for investment decisions from themselves to the participants
- Fiduciary aspects of plan investment management
 - Setting the fund lineup
 - Self-directed brokerage accounts
 - Monitoring of investment advice fiduciaries and investment management fiduciaries

ERISA regulations 2509.75-8

Q & A on fiduciary responsibility

- Persons who perform ministerial functions in plan operation are not fiduciaries
- Some positions within plan administration are fiduciary in nature because of the nature of the work
- Members of the employer's board of directors are fiduciaries only if they have responsibility for functions described in ERISA sec. 3(21)(A)
- There is no required number of fiduciaries that each plan must have, other than the named fiduciary position
- One person may hold more than one fiduciary role
- Functional fiduciaries are liable only to extent that he or she performs a function described in ERISA sec. 3(21)(A)

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