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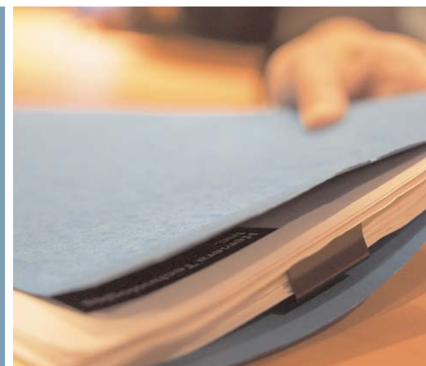
Management of Employee Benefit Plans as a Part of Corporate Governance



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Introduction

A subject that deserves, and is beginning to attract, more attention is the management of employee benefit plans as a part of corporate governance. Employers typically maintain a number of arrangements to provide employees with benefits such as pension, 401(k), health insurance, and group life and disability insurance. According to the U.S. Bureau of Labor Statistics, total benefit costs (including legally-required benefits such as Social Security and workers' compensation) represent, on average, over 30% of total compensation costs for U.S. employers. Employee benefit plans are subject to strict legal requirements and are enforced by numerous state and federal agencies. Yet, in many organizations, benefit programs are not subject to internal governance and oversight procedures commensurate with the sums spent on them, and the potential liabilities under them.

Retirement and welfare benefit plans of private sector employers are generally regulated by the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 (the "Code"). Each statute sets out complex rules. ERISA is enforced by the U.S. Department of Labor, and also provides for lawsuits by plan participants and beneficiaries. Failure to comply with the Code can cause a loss of tax benefits for employers and participants, as well as additional taxes and penalties.

Recent years have seen a significant rise in litigation under ERISA against employers and plan fiduciaries. Participants have brought claims, frequently as class actions, alleging breach of fiduciary duty under ERISA for, among other things, failure by the employer and/or fiduciaries to monitor the activities of those appointed to carry out plan functions, failure to disclose pertinent plan information to participants, and failure to benchmark and limit fees charged against plan assets. These cases became more prevalent beginning with the Enron and WorldCom bankruptcies, which involved huge investment losses in participants' and beneficiaries' plan accounts which were invested in company stock. In light of the impact of such litigation, employers, boards, and plan fiduciaries are reviewing and refining their governance practices and procedures for benefit plans in order to address the evolving fiduciary and governance standards.

A process to align plan management with other corporate governance functions would involve a review of a company's benefit plans in light of ERISA's requirements, issues raised in recent litigation, and the relationship of the benefits program to the organization's functions and goals. Where necessary, corrective procedures will be implemented, as appropriate. Items to be reviewed include the following:

- ***Proper and clear delineation of fiduciaries' responsibility for plan management.*** To be effective, a plan should clearly set forth the scope of fiduciary responsibility. All plan-related documents (such as the trust, investment policy statement, summary plan description, etc.) should be reviewed and harmonized for consistency and coordination between provisions in each document.

One of the best defenses to a breach of fiduciary duty claim is for the plan to establish and maintain a governance structure and processes that address appropriate accountability, written plan policies, effective committees and rigorous oversight.

ERISA contains requirements for plan administration and provides a framework for the designation of those who perform the functions of plan management. Based on this legal framework, a list of the functions necessary to manage the plan (such as day-to-day administration, management of plan assets, communicating with participants, and addressing claims and appeals for benefits) can be prepared, and those responsible for each function identified. It is common for a plan to have one or more committees with responsibility for plan management, such as an investment committee responsible for investment of plan assets and an administrative committee responsible for other functions, with provisions for allocation or delegation of portions of each function. There should be a well-defined responsibility and process for the appointment and review of the members of these committees. Developing a "job description" for committee members or other positions will require analysis of each position and the skills and training necessary to carry it out. A charter or operational guidelines for each committee or position, detailing responsibilities and relationships with the others involved in plan management, provides a guide to the functions and interaction of all who are involved. The documents necessary for plan management (such as a statement of investment policy or procedures for benefit claims and appeals) should reflect the realities of the particular plan's administration, and be carefully followed, reviewed frequently and updated when necessary.

- ***Identifying and addressing fiduciary exposure.*** ERISA uses a functional definition of fiduciary status, which, for our purposes here, focuses on the exercise of discretion or control in plan management. The authority to appoint fiduciaries itself confers fiduciary status. ERISA also provides for co-fiduciary liability for the breaches of other fiduciaries. Therefore, it is necessary to identify which functions in the management of a plan are fiduciary and who is responsible for those functions. The roles of others involved in plan management should be structured so that they report to or advise fiduciaries, or carry out "ministerial" functions. When arranging for the use of internal resources, care must be taken to avoid unconscious allocation or delegation of fiduciary status. Internal resources can be marshaled to provide information or advice to those responsible for plan decision-making, but the actual decision-making is to be reserved to the designated responsible parties. In recent class action lawsuits under ERISA, the named defendants have included numerous board members, officers, service providers and others, leading to lengthy and expensive wrangling over who are the proper parties. The more clearly that fiduciary functions are identified, described and assigned, the easier it will be to separate out non-fiduciaries and provide indemnification and fiduciary insurance for those who are fiduciaries.

- ***Equipping and advising those responsible for plan management.*** Committee members and other fiduciaries require resources and advisors. A formalized periodic review of the responsibilities of those in plan management positions and the standards of conduct and performance applicable to the positions is important for those who are both new and incumbent in plan management positions. Access to necessary external advisors and internal resources should be facilitated. For example, the review and approval of all vendor contracts of a certain amount by legal, as well as purchasing, might be required; or, if a plan's investment consultants present a lengthy and statistic-filled report on asset manager performance, personnel from finance should review it and prepare executive summaries for the members of the plan committee that is responsible for the retention and review of those managers.

- ***Accurate reflection of administrative practices concerning the plan.*** It is not uncommon for plan practices that have evolved over time to be inconsistent with or even contradict plan provisions. This can be a source of liability to the extent it leads to disputes over participant entitilement, or requires participation in a corrective program to fix the plan retroactively.

- ***Review of plan and corporate roles.*** A review of the roles played by the board of directors and various committees can identify potential conflicts of interest or prevent persons from performing inconsistent duties or functions. Plan provisions can be amended to limit board members' exposure to personal liability for plan administration issues by defining the scope of the board's role, which could be as limited as appointing members of the committees charged with plan operation and management.

- ***Adequate language regarding a plan administrator's discretionary authority to determine eligibility or construe plan terms.*** The administrative provisions of a plan may fail to contain language that will ensure a deferential standard of review by a court with respect to a plan administrator's interpretation of plan provisions. The presence of this language will mean that the plan administrator's decision on a particular issue will not be overturned unless found to be arbitrary and capricious – a significant advantage to the plan in benefits claims.

- ***Accuracy of disclosure provided to participants regarding their benefits and rights under the plan.*** ERISA requires that a plan participant be given a summary plan description that is sufficiently accurate and comprehensive to reasonably apprise participants and beneficiaries of their rights and obligations under the plan, along with other disclosures. Proper plan governance requires ensuring that participants are not misled by disclosure that is inaccurate or unclear because any ambiguity or inaccuracy is generally construed in favor of the participant.

- ***Review of fees paid to service providers.*** Benefit plans routinely engage outside consultants and vendors (such as recordkeepers). The contracts and compensation of these service providers should be reviewed by someone who can identify contractual issues and potential liabilities for the company, directors and plan fiduciaries. The Department of Labor has issued extensive guidance on the payment of fees by a plan to service providers. Current payment arrangements should be reviewed in light of this guidance for compliance in the manner such payments are structured. Recently, class action lawsuits have been filed, alleging breaches of fiduciary duty by failing to monitor and control plan expenses. The potential of such suits provides another reason to review fees paid by the plan regularly.

- ***Risk management.*** With the potential for penalties under ERISA and the Code, and an increasing volume of litigation under ERISA, bonds and ERISA liability insurance should be in place with respect to all plan fiduciaries and those who handle plan funds. The coverages and exclusions of ERISA liability insurance and traditional director's and officer's liability insurance should be reviewed and clearly understood.

Conclusion

The importance of benefit plan management in the broader context of the management of the enterprise is being recognized in more organizations. The central role of these plans in the employees' compensation package, the amount spent to provide benefits, the magnitude of potential legal exposure in the current climate of ERISA litigation, and the interaction of benefit plans with other aspects of operations, all argue for an approach to plan management that is consistent with ERISA and the particular features of the employees' plans, and integrated with the rest of the management of the enterprise. A plan compliance and governance review may serve as a useful tool to identify and address what is necessary to achieve this goal.

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