Fiduciary Responsibilities for Non-ERISA Non-profit 403(b) Plans

This first of a series looks at the fiduciary responsibilities of non-ERISA 403(b) plans established and maintained by non-profit employers.

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This is the first of a three-part series that summarizes the fiduciary responsibilities for sponsors of retirement plans that are not subject to ERISA. This initial article addresses the non-ERISA 403(b) plans established and maintained by non-profit employers. In it, we will discuss:

- the fiduciary responsibility framework found in ERISA so that we have a familiar canvas to use in our analysis;
- how non-profit employers must structure their plans to avoid having their 403(b) plan subject to ERISA; and
- the possible non-ERISA law that could be applicable to the employer.

The second article in the series will cover non-ERISA church plans, and the third will cover non-ERISA governmental plans.

ERISA'S FIDUCIARY FRAMEWORK

ERISA applies to employee pension benefit plans established or maintained by an employer unless specifically exempt from the law due to their status as a governmental plan, a church plan or a plan with limited employer involvement.

ERISA was enacted in 1974 and the federal courts have applied significant judicial interpretation to its provisions over the last 40 years. The most significant aspect of the law's scope is that ERISA preempted all states laws that could possibly apply to an ERISA-governed plan, in order to create a uniform national system. The primary features of ERISA's fiduciary responsibility regime are:

(1) an articulated definition of who is a fiduciary that includes not only defined roles but also a functional test that may end up including those who never intended to be a fiduciary but acted like one because of their discretionary control over a plan;

(2) a defined list of fiduciary duties, including the duty of loyalty, duty of prudence, the duty of diversification and the duty to follow the plan document. In addition, ERISA defined certain transactions called "prohibited transactions" that are by their nature automatically disallowed because of the possibility of conflict of interest. However, these prohibited transactions may be counteracted by a robust group of prohibited transaction exemptions that are found in the statute and that have been administratively granted by the Department of Labor;

(3) a robust enforcement scheme where lawsuits may be filed in federal court by plan participants, beneficiaries, fiduciaries or the Secretary of Labor. Claims typically fall into two broad categories: breach of the fiduciary duties and claims for benefits due under the terms of the plan. Additionally, the DOL has multiple offices throughout the country broken up into regions that have investigative and auditing power over ERISA-governed plans.

In obvious consequence to the third point, the second most significant source of law governing ERISA plans is case law developed by the federal court system. Additionally, the DOL also regularly supplements ERISA by issuing regulations, advisory opinion letters, field assistance bulletins and interpretive bulletins.

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AVOIDING ERISA BUT NOT THE INTERNAL REVENUE CODE

A 403(b) plan, also known as a tax-sheltered annuity (TSA) plan, is a retirement plan eligible to be sponsored by employers such as Code Section 501(c)(3) organizations (otherwise known as non-profit organizations), public education institutions and certain ministers. As discussed above, this article will focus on the first group of employers; later articles will focus on the others.

While 403(b) plans have been in existence dating back to the 1950s, for many years they enjoyed little regulation. In 2007, the IRS finalized regulations governing 403(b) plans that primarily went into effect in 2009.[1] The most far-reaching consequence of the new regulations was that all 403(b) plans are now required to have a plan document.

1 26 CFR 1.403(b)-1

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The full regulations and the statutory requirements found in the Internal Revenue Code apply to all 403(b) plans and must be met by sponsors.

However, as noted above, non-profit employers who sponsor 403(b) plans and who have limited involvement with the plan can choose to not fall under regulation by ERISA. Under the exemption articulated by the DOL in two recent advisory opinions:[2]

- there can be no employer contributions;
- the employer must have minimal administrative involvement with the plan; and
- the plan must be voluntary for plan participants.

If a non-profit employer meets this safe harbor and avoids application of Title 1 of ERISA, then any responsibilities which must be met in addition to those found in the Internal Revenue code will be found in state law. These laws are discussed in the next section.

SOURCES OF NON-ERISA FIDUCIARY RESPONSIBILITY

The first thing an employer must do to understand which laws apply is to perform a search of the laws in their state. No two states have the same laws, either because different statutes have been passed or case law has developed differently over time. A qualified attorney can perform this search if the employer is unable to do so.

It is impossible to describe and analyze the fiduciary common law in all 50 states. Thus, the sources below are generalized but should provide a robust road map to finding and understanding your state's laws.

State Common Law of Trusts and the Restatement of Trusts

Common law, which is also known as case law or precedent, is law developed by judges through decisions of courts and similar tribunals, as opposed to statutes adopted through the legislative process or regulations issued by the executive branch. Such legal practices have the same legal force as if they were passed into law by a state's legislative body.

Responsibilities are most likely to arise under the common law of trusts. Due to multitude of state variations, the Restatement of Trusts has typically been used to represent the prevailing developments in the common law. Restatements are important secondary sources of law published by the American Law Institute (ALI). As the name implies, the Restatements attempt to "restate" the common law rules on various topics.

The Restatement of Trusts was one of the first Restatements to be compiled in 1937. The substance of this Restatement is useful in determining consistent principles of non-ERISA fiduciary responsibilities. The Second Restatement of Trusts was finalized in 1959, and stands as the foundation of the common law in effect at the time ERISA was enacted in 1974. The ALI adopted the Third Restatement of Trusts in 2001. Accordingly, the most recent edition serves as a representation of the common law rules of fiduciary status after ERISA's enactment.

The trustee's duty to administer the trust commences when the individual accepts the appointment. The standards governing the trustee's duties include "diligence" and "good faith in accordance with the terms of the trust and applicable law."[3] The Restatement sets forth the trustee's responsibilities when administering the trust and execution of the following functions:

- ascertaining the duties and powers of the trusteeship, and the beneficiaries and purposes of the trust;
- collecting and protecting trust property; and
- managing the trust estate to provide returns or other benefits from trust property.[4]

The trustee has "core" and "ancillary" fiduciary responsibilities under the Restatement that they must follow with regard to plan administration. These duties are similar to the ones found in ERISA §404. In the Restatement, robust commentary on the duties can be found which help provide context and guidance.

Core Duties. The Restatement contains three fiduciary duties classified as core duties:

- Duty of Prudence (Restatement §77)[5]

2 See DOL Field Assistance Bulletins 2007-02 and 2010-01 for more detailed information.

3 Restatement (Third) of Trusts §76 (2007).

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5 (1) The trustee has a duty to administer the trust as a prudent person would, in light of the purposes, terms, and other circumstances of the trust.
(2) The duty of prudence requires the exercise of reasonable care, skill, and caution.
(3) If the trustee possesses, or procured appointment by purporting to possess, special facilities or greater skill than that of a person of ordinary prudence, the trustee has a duty to use such facilities or skill.

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Laws (NCCUSL). The NCCUSL is a non-profit unincorporated association that brings clarity and stability to critical areas of state statutory law.

The Uniform Trust Code (UTC) is the most pertinent Uniform law when analyzing non-ERISA fiduciary duties. The UTC provides a comprehensive model for codifying the law on trusts. While the UTC has been adopted in majority of states, there are considerable state-by-state differences. As of the date of this article, 34 states have adopted the UTC; one state, New Jersey, introduced the bill in 2014.

With the model UTC being drafted closely with the Restatement of Trusts, the two share similarities. But because of the changes made to the UTC when adopted by each state, while the above description of the Restatement duties is helpful, only a proper review of your state's UTC as adopted will provide the actual responsibilities.

The Restatement's Prudent Investor Rule and the Uniform Prudent Investor Act

The Restatement also provides duties specific to investing. The General Standard of Prudent Investment (Restatement §90) incorporates some of the earlier duties such as prudence and loyalty.[13] Additionally, the Restatement §91 requires adherence to investment provisions found in the trust itself or in a statute.[14]

Similar to the adoption by states of the UTC, the Uniform Prudent Investor Act (UPIA) has been adopted with modifications by a limited number of states. The UPIA attempts to provide a model statute for adoption that strongly correlates to the Prudent Investor Rule.

Other State Common Law or Statutes

Even if a state's specific fiduciary trust laws will not apply to an employer's actions, other state law claims may be asserted. For example, if a plan participant files suit for benefits allegedly owed under a plan, that claim may be brought as a breach of contract claim. Depending on the state, the law governing the plan could be found in common law or the state may have adopted the Uniform Commercial Code or UCC, which may have applicability, again, depending on how the state crafted the law when it was adopted.

Alternatively claims can be brought under an agency/principle theory if the facts support it. Claims have also been brought as tort claims for negligence. Finally, more and more claims are being brought under a state's consumer protections laws. If this type of law arguably applies in your state, make sure to fully understand the types of claims and damages that can be sought, as typically these laws include provisions for punitive damages or double/triple damages if the facts support it.

CONCLUSION

Employers have a duty to search the specific state laws in which they operate. The outline above may inform that research. The non-profit sponsor of a non-ERISA 403(b) plan is advised to understand the laws and look for ways to implement best practices (which may include ERISA best practices) in order to ensure their conduct is consistent with them. PC

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13 The trustee has a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.
   (a) This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.
   (b) In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.
   (c) In addition, the trustee must:
      (1) conform to fundamental fiduciary duties of loyalty (§78) and impartiality (§79);
      (2) act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents (§80); and
      (3) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship (§88).
   (d) The trustee's duties under this Section are subject to the rule of §91, dealing primarily with contrary investment provisions of a trust or statute.

14 In investing the funds of the trust, the trustee
   (a) has a duty to conform to any applicable statutory provisions governing investment by trustees; and
   (b) has the powers expressly or impliedly granted by the terms of the trust and, except as provided in §§66 and 76, has a duty to conform to the terms of the trust directing or restricting investments by the trustee.