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Section 403(b) Plans

Question of Fiduciary Status Crucial for Public School Sponsors of 403(b) Plans



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Public schools in the United States that sponsor tax code Section 403(b) plans have experienced a significant increase in compliance obligations since the Treasury Department and Internal Revenue Service issued final Section 403(b) regulations in July 2007 (141 PBD, 7/24/07; 34 BPR 1777, 7/31/07).

A recurring question that public schools and their legal counsel are asking is whether they now have fiduciary duties to plan participants under the Employee Retirement Income Security Act or other laws and regulations. Public schools include public elementary and secondary schools, public colleges and universities, and community colleges.

Why Is This Question Important? Getting an accurate answer to the fiduciary question is important because school risk officers must know the risks to which a

school may be subject and must evaluate the sufficiency of insurance protection. Public schools routinely receive advice from legal counsel about the potential for legal or financial liability for past or proposed school activities.

Such advice is especially valuable when a public school is evaluating a claim from a third party that fiduciary duties already apply to the school or that the school should adopt an ERISA or other fiduciary standard as a “best practice,” even if the obligation does not technically apply.

Legal advisers generally are prevented by professional and ethical standards from recommending that clients accept unnecessary liability. On the other hand, it is conceivable that a public school client might have an independent business justification for taking on fiduciary liability.

If a lack of legal clarity results in an elevated risk of liability, fiduciary or otherwise, adopting a specific liability standard, fiduciary or otherwise, may have merit. However, if the potential for liability under applicable laws and regulations is low or nonexistent, accepting liability may be contrary to a public school's interests.

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Fiduciary duties, like other legal duties, do not arise simply of their own accord. Therefore, any answers to questions about fiduciary liability should identify the source and the scope of the liability that might apply. Only then can a public school make informed decisions that may require allocating limited fiscal resources to cover the liability.

All public schools that maintain 403(b) plans have regulatory compliance responsibilities and associated income tax obligations. In contrast, the extent to which a public school may be subject to fiduciary duties, if at all, may vary from state to state. If state laws impose fiduciary duties on a public school, or if a school voluntarily implements a fiduciary-like standard, it can create a new class of claimants—plan participants—and a high standard of responsibility that carries with it higher potential liabilities for failing to get it right.

Because fiduciary duties can vary depending on the specific state and employer, definitive answers to the fiduciary question for public school 403(b) plan sponsors are outside the scope of this article. In general, however, the question of whether a fiduciary duty exists can have four answers. For many public schools, the answer will be that no fiduciary duty exists. For some public schools, the answer may be yes. For others, the answer may be unclear. Moreover, the answer might change, depending on actions that the public school takes. In that respect, fiduciary liability may become a self-fulfilling obligation if a school's actions cause the school to assume fiduciary duties that otherwise would not have applied.

Federal Law

Perhaps the easiest place to start analyzing whether fiduciary standards apply to public school 403(b) plans is at the federal level. Two possible sources of fiduciary duties for public schools can be easily set aside: the Section 403(b) regulations and Title I of ERISA¹ The Section 403(b) regulations impose important plan compliance responsibilities. However, neither those regula-

¹ Employee Retirement Income Security Act of 1974, as amended.

tions nor the Internal Revenue Code² provisions they interpret and apply include any mention of fiduciary duties and liabilities. Title I of ERISA would impose fiduciary duties if they were applicable. However, governmental plans, including public school 403(b) plans, enjoy a broad exemption from ERISA Title I that is unchanged by the Section 403(b) regulations.³

Therefore, to the extent that a public school has any fiduciary duties, those duties are not interpreted or enforced by the Department of Labor. It is unclear whether a court would have any obligation to apply DOL guidance or interpretations to resolve a dispute if an employer voluntarily assumed ERISA-like fiduciary duties and standards.

State Law

Setting aside federal law, we are left with state law and common law as possible sources of fiduciary duties.

Sovereign Immunity. An important starting place is the principle of state law known as sovereign immunity. Sovereign immunity, which is a governmental body's immunity from claims generally or from specified claims, often is an important principle for public employers to consider when analyzing questions of liability. If a public employer is immune from liability (unless it consents to such liability, in whole or in part), and if that immunity has not been limited to exclude one or more functions under a 403(b) plan, it would be difficult for a participant in a 403(b) plan to assert a claim for breach of the employer's duties to the participant.

However, there are a number of exceptions to sovereign immunity, which can vary from state to state, and the interaction of sovereign immunity and fiduciary duties might give rise to additional questions. Nevertheless, in the absence of an express imposition of fiduciary duties, as may be the case if state laws are silent about a plan sponsor's liability, sovereign immunity may a good place for a public school to begin its analysis of potential liability.

State Statutes. Beyond the general hurdle of sovereign immunity, many states have enacted statutes specifically authorizing public schools to sponsor 403(b) plans, and those 403(b) enabling statutes may be relevant to questions of potential fiduciary liability. Many 403(b) enabling statutes expressly limit a public school's potential liability as sponsor of a 403(b) plan, as in these examples:

- Some states allow a public school to exclude a prospective investment provider if the school determines that it must do so to comply with 403(b) regulations. For example, a provider might be excluded if it

² Internal Revenue Code of 1986, as amended.

³ 29 U.S.C. § 1003(b)(1) (2007); ERISA defines a “governmental plan” as “a plan established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. The term governmental plan also includes any plan to which the Railroad Retirement Act of 1935 or 1937 applies, and which is financed by contributions required under that Act and any plan of an international organization which is exempt from taxation under the provisions of the International Organizations and Immunities Act (59 Stat. 669).” 29 U.S.C. § 1002(32) (2007).

refused to share information necessary to achieve plan-level compliance. Texas and California have 403(b) enabling statutes that are examples of that approach.⁴

■ Some states put other limitations on the possible liability of public schools that sponsor 403(b) plans. For example, Arizona statutory language reads as follows:

“The amount to be invested shall be determined by the employee not less than fifteen days before the employee’s first payday in the school year, or any time during the school year at the option of the governing body. The employing body or county school superintendent shall assume no responsibility other than to make the requested payments during the actual time of the employment of the employee.”⁵

Florida statutory language reads as follows:

“The purchase of such tax-sheltered annuity or other investment qualified under the United States Internal Revenue Code and not prohibited under the laws of this state for an employee shall impose no liability or responsibility whatsoever on the employing agency except to show that the payments have been remitted for the purposes for which deducted.”⁶

Some other state statutes are simply silent about possible liabilities, giving both sides an opportunity to argue the point but most likely putting the greater burden on the plaintiff participant to demonstrate that (a) the school had a specific duty to the participant, (b) the school breached that duty, and (c) the school may be held financially accountable to the participant as a result.

Any analysis of potential fiduciary duties and liabilities associated with a public school’s 403(b) plan should give careful consideration to the relevance of enabling statutes and any limitations on liabilities that they may provide.

Some Section 403(b) enabling statutes clearly impose, or could be read to impose, fiduciary duties on the plan sponsor. A Minnesota statute, for example, expressly imposes a fiduciary standard on certain 403(b) plan sponsors in that state. The statute applies specifically to teachers’ retirement fund associations in the Minnesota cities of Duluth and St. Paul and appears to impose fiduciary duties with respect to retirement plans, including 403(b) plans, that the associations are authorized to establish.⁷ The Minnesota example, however, appears to be different from other 403(b) enabling statutes.

Any fiduciary analysis should not stop at state-level 403(b) enabling statutes. Other state statutes may impose fiduciary duties on specific parties. It may be important to determine whether those statutes apply to public school 403(b) plan sponsors. Examples include the Uniform Fiduciary Act and Uniform Prudent Investor Act laws,⁸ which might be adopted by states either verbatim or with modifications, and laws governing state retirement systems.

⁴ Tex. Rev. Civ. Stat. art. 622a-5 (2007); Cal. Educ. Code §§ 24950 – 24953; 25100 – 25115 (2007) .

⁵ Ariz. Rev. Stat. § 15-121 (2008).

⁶ Fla. Stat. ch. 112.21 (2008).

⁷ Minn. Stat. § 354A.021 (2007).

⁸ Unif. Fiduciaries Act (1922) §§ 1 et seq.; Unif. Prudent Inv. Act (1994) §§ 1 et seq.,

“Even in the case of a private tax-exempt employer maintaining voluntary 403(b) plans, the selection of investment providers does not cause an otherwise exempt plan to become subject to Title I of ERISA, provided that participants are given a reasonable choice of investment arrangements and providers.”

Both the Uniform Fiduciary Act and the Uniform Prudent Investor Act impose specific duties or standards on parties that are fiduciaries but generally do not themselves cause a party to be a fiduciary. Thus, one or both of the laws might apply to a Section 403(b) plan sponsor that already was a fiduciary. However, those laws most likely would not cause a party that otherwise was not a fiduciary to become one.

As a general matter, state retirement systems impose fiduciary duties on the parties responsible for investing the assets underlying the pension promises of state pension plans. However, many of those statutes do not apply to Section 403(b) plans maintained by public schools within the state. In addition, the role of selecting available investment providers from which the employee participants may select is quite different from the role of an asset manager under a state pension plan.

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Actions That May Create Fiduciary Duties

Any fiduciary analysis should include questions about actions of public school 403(b) plan sponsors that might give rise to, or prospectively limit, their fiduciary duties.

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First, if a public school is not otherwise a plan fiduciary with respect to its 403(b) plan, are there actions that it might take that could cause such duties to apply?

⁹ 29 C.F.R. § 2510.3-2(f).

The answer to that question, at least in some situations, may be yes. For example, an employer that creates its own 403(b) investment platform might be viewed as forfeiting available statutory protections. A South Carolina court found that, although a school district did not have a general fiduciary duty to its employees, it did have such a duty with respect to what it had undertaken.¹⁰

Second, if an employer has undertaken more responsibility than would have been required under applicable legal duties, can it make prospective changes to reduce its potential risk exposure? In many cases, an employer may be able to modify its role and reduce its duties going forward.

For example, an employer that determines it has assumed fiduciary duties, either intentionally or unwittingly, by adopting an investment policy statement and assuming direct responsibility for oversight of a significantly limited plan investment lineup, could continue to

¹⁰ See *Davis v. Greenwood School District* 50, 620 S.E. 2d 65 (S.C. 2005). *Davis* is a South Carolina Supreme Court decision that interprets and applies South Carolina law. The decision appears to narrowly apply the fiduciary status to specific duties that the district has to the employee, in this case with respect to a duty to pay a promised incentive for teachers to obtain certain certifications.

assume that liability or modify its approach. If the employer modified its approach and reduced its potential liabilities, the effect most likely would be prospective and would not affect liabilities already assumed for prior periods.

Conclusion

Neither ERISA nor Section 403(b) regulations impose fiduciary responsibilities on public schools that sponsor 403(b) plans. State law may or may not impose a fiduciary duty on public schools. In many cases, state laws do not impose such liabilities. However, public schools that sponsor 403(b) plans should review and analyze the laws of their state to determine what, if any, fiduciary duties may apply to their 403(b) plan. If a public school and its counsel do not find a credible basis for fiduciary duties generally, the employer can either:

- elect to accept those fiduciary duties and the associated potential liabilities, or
- design its plan and related decisions to minimize the risk of unintentionally assuming fiduciary duties.

In other words, absent a legal basis for such liability, the decision, and the associated analysis of risk and reward, remains with the employer.

