

ERISA PRUDENT PROCESSES: REDUCING ERRORS AND LITIGATION RISK

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ERISA Fiduciary Duties



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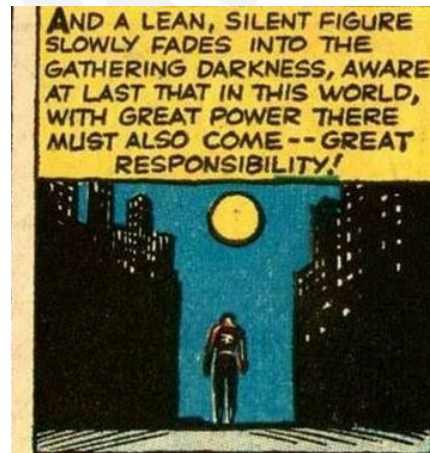
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ERISA IN A NUTSHELL

ERISA = Trust law

- Hold assets separately (“in trust”) for another person’s benefit (here, P&Bs).
- Fiduciary has:
 - *Power* to make decisions.
 - *Responsibility* (liability) to manage those assets for the other person as if they were their own.

With great power comes great responsibility . . .



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IDENTIFYING FIDUCIARIES

Fiduciaries are:

- Named Fiduciary (IDed in Plan Document) – usually employer, which then delegates to a Benefits Committee.
- Investment Advisor – advice for a fee, per 3(21).
- Investment Manager – 3(38).
- Anyone else that *accepts* or *exercises* discretionary authority or control over plan assets or plan administration.

Not Fiduciaries:

- Ministerial Administrators (*i.e.*, acting at a fiduciary's direction, within framework of policies/practices).
- Employer when acting as settlor (e.g., creating, amending, funding, or terminating a plan).

Key points:

- (1) This is a functional test and you can become a fiduciary simply by acting like one.
- (2) HR personnel can be a fiduciary for some acts and not for others (2 hat theory) . . . so know which hat you are wearing!
- (3) If a fiduciary delegates a duty entirely to another fiduciary, they still retain the duty to monitor the delegate.

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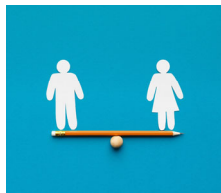
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IDENTIFYING FIDUCIARIES

MINISTERIAL FUNCTIONS:

1. Application of rules determining eligibility for participation or benefits.
2. Calculation of benefits.
3. Preparation of employee communications.
4. Maintenance of participant records.
5. Processing claims.
6. Collection of contributions.
7. Orientation of new participants and advising of rights.
8. Preparation of reports concerning participant.

29 C.F.R. § 2509.75-8



FIDUCIARY ACTIONS:

1. Interpretation of plan ambiguities (Section 3(21) of ERISA).
2. Independent adjudication of appeals.
3. Having final authority over disputed eligibility interpretations. 29 C.F.R. § 2509.75-8
4. Making discretionary eligibility determinations.
5. Providing incomplete or inaccurate plan information and/or advice that affects benefit decisions.

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EXAMPLE: UNILATERAL ACTIONS AND INTERPRETATIONS

- *Gill v. Bausch & Lomb Supplemental Ret. Income Plan I*, 1 F. Supp. 3d 72, 84 (W.D.N.Y.), aff'd, 594 F. App'x 696 (2d Cir. 2014)
 - Executive compensation plan covering 3 employees – Committee was “named fiduciary” with authority to interpret/determine plan terms, while VP of HR was “administrator.”
 - Change of Control occurred; purchasing company asked HR what benefits were due.
 - Usually, persons without power or discretion to make decisions or interpret plan provisions, but who “perform [certain] administrative functions for an employee benefit plan **within a framework of policies, interpretations, rules, practices and procedures made by other persons,**” are **not fiduciaries.**
 - BUT: here, HR exhaustively discussed and debated the proper interpretation of plan terms (both in-house and with a host of outside benefits specialists, actuaries, and attorneys), and then—based on their own interpretation and that advice, *and without consulting the Committee*—determined the rights and benefits owed to employees, terminated their monthly benefits, and distributed remaining benefits in lump sum.
- **HELD:** HR acted with discretion and was therefore a fiduciary; summary judgment granted.

EXAMPLE: DUTY TO PROVIDE ACCURATE INFORMATION

- *Erban v. Tufts Med. Ctr. Physicians Org., Inc.*, 795 F. Supp. 3d 176, 179 (D. Mass. 2025)
 - Spouse of terminally ill employee asked HR how she could preserve his life insurance benefits.
 - HR Director did not advise to pay premiums or provide conversion forms but also did not refer her to carrier for further information or direction.
 - HR's inaccurate and incomplete information resulted in carrier denying benefit claim.
 - HR Director was a “functional fiduciary” because he was aware of the illness and affirmatively assumed sole point of contact role for benefits questions, which beneficiary reasonably relied on.
 - HELD: HR Director and Employer breached fiduciary duties related to disclosure; summary judgment granted for plaintiff (so, plan responsible for >\$800k in damages).
- Compare with: *Watson v. Deaconess Waltham Hosp.* (2001) – In same jurisdiction, mere performance of ministerial administrative tasks ≠ fiduciary status.

EXAMPLE: FAILURE TO INVESTIGATE OR ASK QUESTIONS

- *Su v. Bensen, No. CV-19-03178-PHX-ROS, 2024 WL 3825085 (D. Ariz. Aug. 15, 2024)*
 - Company sued by DOL because ESOP purchased shares at above market value in an accelerated timeline at Company’s behest (and to its benefit).
 - In deposition, HR VP (as committee member/fiduciary) asserted that he didn’t adequately understand the ESOP rules because he wasn’t a lawyer.
 - Court: Defendants must know the rules or take steps to learn because “**a pure heart and an empty head are not enough.**”
 - A plaintiff “need not prove that the fiduciary acted in bad faith” but “it breached its fiduciary duties by failing to act solely in the interest of the participants” with appropriate care and diligence. The focus is not on the fiduciary’s motives or actual knowledge but “**on whether the fiduciary “engaged in a reasoned decisionmaking process, consistent with that of a prudent man in like capacity.”**”

OK, I’M A FIDUCIARY – NOW WHAT?

Thou SHALL (ERISA 404):

- Act prudently and diligently (“Care”)
- Act exclusively in P&B’s interests (“Loyalty”), highest duty in the law
 - Follow Plan terms, procedures, and the law
 - Provide benefits; pay only reasonable expenses
 - Diversify investments
 - Provide timely/complete/accurate information
- Avoid conflicts of interest

Thou SHALL NOT (ERISA 406):

- Commit Prohibited Transactions



... FIDUCIARY MISTAKES ARE COSTLY



Fiduciary breach = liability to restore losses from the breach (ERISA 409), plus potential:

- Civil Penalties (ERISA 502)
- CRIMINAL liability (ERISA 411, 501, 511), state and federal.
- Other equitable or remedial relief (like removal as fiduciary)

Note: the liability is *personal* (i.e., YOUR house, car, boat, and freedom is at stake)

This may still affect you even if a *different* fiduciary breaks the rules! (ERISA 405)

Common Mistakes & Corrections



COMMON RETIREMENT PLAN ERRORS

• Operational Errors

- Occur when the plan is not run in accordance with its written terms.
- **Example:** The plan document says to do X, but the employer did Y.
- Most common type of error.

• Plan Document Error

- Occur when the plan document itself is defective.
- **Example:** The plan document should say X, but it says Y (or fails to say anything at all).



EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM (EPCRS).

- There are 3 IRS programs for correcting operational and plan document retirement plan errors.
- Correcting via EPCRS allows a plan to preserve its tax-exempt status, but not correcting an error (or correcting improperly) results in disqualification.
 - Employees must include vested employer contributions in gross income.
 - Employer's ability to deduct contributions is limited.
 - Plan owes income taxes on trust earnings.
 - Rollovers are disallowed.
 - Contributions are subject to Social Security, Medicare, and Federal Unemployment (FUTA) taxes.

EPCRS CORRECTION PROGRAMS

Self-Correction Program (SCP)	Voluntary Correction Program (VCP)	Audit Closing Agreement Program (Audit CAP)
<ul style="list-style-type: none">• Can correct certain errors without contacting the IRS or paying a fee.• Primarily available for insignificant operational failures (at any time) and significant operational failures (within 3 plan years).	<ul style="list-style-type: none">• Requires paying a fee and submitting an application to IRS.• Available for significant operational errors not available for self-correction (at any time prior to an IRS audit).	<ul style="list-style-type: none">• Can correct plan errors after an IRS audit by making an approved correction, entering into a Closing Agreement with the IRS, and paying sanctions.

SIGNIFICANT VS. INSIGNIFICANT ERRORS – FACTORS

- Other failures in the same period (not how many people are affected)
- Percentage of plan assets and contributions involved
- Number of years it occurred
- Participants affected v. the total number participating in the plan
- Participants affected v. the total number that could have been affected
- Length of time between discovery and correction
- Reason for the failure

SIGNIFICANT VS. INSIGNIFICANT ERRORS – EXAMPLES

Example 1: A 401(k) plan with 300 participants fails to timely enroll 2 eligible employees for one plan year due to an administrative oversight. The missed deferrals total \$3,000, which is 0.2% of total plan contributions for the year. The error is discovered and corrected promptly in the following year, and no other failures are identified.

***Likely insignificant
(self-correct)***

Example 2: A 401(k) plan with 300 participants fails to enroll a group of 100 eligible employees over a three-year period due to a misapplication of the plan's eligibility provisions. The excluded employees collectively miss substantial deferrals and matching contributions. The error affects approximately 33% of the eligible workforce and is only discovered after persisting across multiple plan years. The plan does not take steps to correct for 1 year after discovery.

***Likely significant
(correct via VCP)***

GENERAL CORRECTION PRINCIPLES

- Errors must be fully corrected for all affected participants, beneficiaries, and years (with some very limited exceptions).
- Corrections must restore the plan to the same position it would have been in if the failure had not occurred at all.
- Corrections must be reasonable and appropriate.
- If there is more than one reasonable and appropriate correction, the correction method should be applied consistently for all failures occurring in the same plan year.
- Corrective contributions, distributions, allocations, and reallocations should be adjusted for earnings and forfeitures from the date of the failure through the date of the correction.



EXAMPLES OF COMMON ERRORS

- Improper exclusion of eligible employees.
- Using an incorrect definition of compensation.
- Failure to implement an employee's deferral election.
- Failure to make required matching contributions.
- Failure to obtain spousal consent.
- Failure to adopt required amendments.



The Good News? All are correctable!

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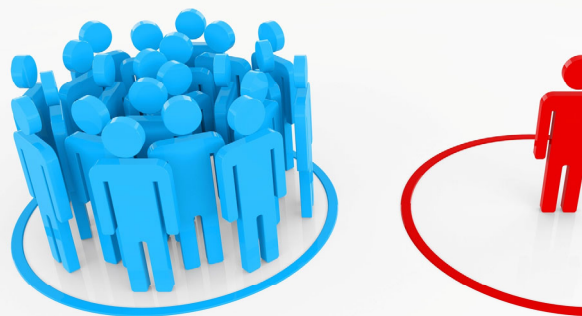
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IMPROPER EXCLUSION OF ELIGIBLE EMPLOYEES

An Insignificant Operational Error

- **Example:** Felix satisfied the plan's eligibility requirements on January 1, 2024. However, due to administrative oversight, Felix was not given the opportunity to enroll in the plan until January 1, 2026. As a result, he did not make any elective deferrals and did not receive any employer matching contributions. The error was discovered by Purrformance Industries during a plan review in 2026. Felix is a NHCE with eligible compensation for 2024 of \$50,000. The Actual Deferral Percentage for 2024 was 8% for NHCEs.
- **Correction:** Purrformance Industries must make a qualified nonelective contribution (QNEC) to Felix. Felix's missed deferral amount was \$4,000 ($\$50,000 \times 8\%$), so the company must make a QNEC of \$2,000 (50% of the missed deferral), adjusted for earnings through the date of correction.



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FAILURE TO IMPLEMENT A DEFERRAL ELECTION

An Insignificant Operational Error

- **Example:** On January 1, 2024, Archie completed a deferral election to increase his deferral percentage to 10% of his pay. Archie's election was never processed by Purrformance Industries' payroll system. As a result, Archie received taxable compensation amounts that should have been contributed to the plan until his election was processed on July 1, 2024. From January 1 to July 1, 2024, Archie's eligible compensation was \$35,000.
- **Correction:** Purrformance Industries must make a QNEC to Archie. Archie's missed deferral amount is \$3,500 ($\$35,000 \times 10\%$), so the company must make a QNEC of \$1,750 ($\$3,500 \times 50\%$).

FAILURE TO ADOPT REQUIRED PLAN AMENDMENTS

A Plan Document Error

- **Example:** 401(k) plans were required to be amended by December 31, 2025, to increase the RMD age to 73. Purrformance Industries operated the plan in compliance with the updated rules but failed to adopt a conforming amendment by the deadline.
- **Correction:** Purrformance Industries must retroactively adopt the required amendment.
 - If the error is discovered and corrected prior to December 31, 2027 (the end of the second plan year following the amendment deadline), Purrformance Industries can self-correct.
 - If the error is discovered and/or corrected later, Purrformance Industries must submit a VCP application.

DOCUMENT IT (OR IT DIDN'T HAPPEN)

- The IRS requires plan sponsors to keep adequate records to show correction in the event the plan is audited.
- **Even when you are self-correcting**, it is best practice to have counsel draft a memo to file that sets forth, at a minimum:
 - A description of the error
 - Why the error is insignificant (applying factors)
 - Details of the correction and why that method was chosen (if multiple corrections were available)
 - What processes or procedures are being implemented to prevent future errors.



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Best Practices



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DOCUMENTING DECISIONS AND ACTIONS

- You should be able to point to a written plan document provision, policy, procedure, or other document *approved by the Committee* that describes what actions will be taken and in what circumstances.
 - If HR develops, maintains, and implements the policy without approval from the named fiduciary, HR is now a fiduciary.
- Minutes can be a lifesaver but are underappreciated and/or misused.
 - Main purpose is to document decisions and the rationale for it, which ensures consistent administration; is also a great resource to future fiduciaries.
 - Minutes are discoverable and a key source of evidence in summary judgment motions, so Plan Counsel should draft ideally (or at least review).
 - Not ideal for consultants or TPA to draft – cost savings are minimal and output usually serves their interests (rather than the Plan’s) due to bias or ignorance.

COMPLIANCE CALENDAR

- Some deadlines are fixed dates and some are based on “Plan Year,” e.g.:
 - **April 15** is a fixed deadline to process most IRS-related corrections for prior tax year.
 - Form 5500 deadline is due last day of 7th month after PYE (so July 31 for calendar year plans).
- Activity is year-round but second and fourth quarters are a bit busier.
- Best Practices:
 - Have a custom calendar built which sets out all the relevant filing or distribution deadlines and the dates to receive data needed to meet the filing deadlines, and reminders to request data in advance of the receipt / filing deadlines.
 - Have “plan” specific calendar and a global calendar with all due dates, since not all plans will have same plan year (fully insured plans are usually calendar year, while employer-sponsored plans often use fiscal year).
 - Don’t neglect state filing responsibilities and deadlines.

FIDUCIARY CALENDAR (CORE DUTY EXAMPLE)

Meeting 1: SERVICE PROVIDERS

- Qualitative Service Provider Review
- Review Participant communications
- Review Fee Disclosures/Expenses
- Determine if fees are reasonable

Meeting 3: GOVERNANCE

- Review Charter and other document
- Review and renew Fiduciary Insurance Policy
- Review Form 5500 and other state/fed filings

Meeting 2: INVESTMENT DEEP DIVE

- Review Investment Policy Statement
- Review Investment Lineup (Share Classes, Performance, Composition, QDIA)
- Assess performance benchmarks (reasonable)
- Special Considerations: Brokerage Accounts, Alternative Investments, Cryptocurrency

Meeting 4: ADMINISTRATION

- Review Plan Administration Report
- Review Participant engagement / education
- Approve next year's Committee calendar

ANNUAL ADMINISTRATION REPORT

- Fiduciary decisions are rarely “one and done” and require ongoing monitoring and regular information.
 - An annual report can be used to summarize the Committee's activities and actions, which then is evidence that the Plan Sponsor is monitoring the Committee (and that the Committee is monitoring *its* delegates).
- Best Practices:
 - Highlight any decisions made by the Committee, monitoring, and special reviews. ***Plan sponsors need enough information to see evidence of process, not to decide if the decision was the best one.***
 - Use in conjunction with fiduciary calendar (highlights what was done, and when).
 - Useful internally (HR) or in an audit if the report utilizes document management system links or document IDs – documents aren't much use if not locateable.

“WORKING” PLAN DOCUMENT

- Between restatements, we recommend clients create and develop a “working” plan document and SPD, and use internally.
 - i.e., provide only the signed Plan Document in PDF, with amendments and SMMS, to participants or in response to document requests – not the working version.
- This document uses redlines to incorporate amendments as they occur, which facilitates good administration and simplifies restatements.
- **Best Practices:**
 - Use comments to identify ambiguities in the plan – along with the Committee decision resolving the ambiguity, the date of the decision, and where the decision is reflected (e.g., in minutes) – this improves consistency in administration
 - Also use comments to identify items which are in effect but for which an amendment has not yet been executed (e.g., SECURE 2.0 stuff)

Takeaways



THE BAD NEWS

- Fiduciaries are created by act, not intent – you can be one by accident.
- Fiduciaries have high standards (the highest in the law).
- Two-Hat situations are uncomfortable: there are often conflicting or diverging interests between company and plan participant.
- Breach Penalties are Harsh
 - Personal Liability
 - Potential Criminal Liability
- Solution is process but that means more work and constant diligence.

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- **No need to be perfect.**
 - Perfection is not the standard and actions are not judged with benefit of hindsight.
 - The test is whether you have a robust, reasonable, and well-documented process, not whether good outcomes result or mistakes never occur.
- **No need to do this alone.**
 - *As Administrator:* defer to the named fiduciaries to make decisions and default to referring matters to them.
 - *As Fiduciary:* You can (and SHOULD) hire experts to advise and guide, and may delegate some fiduciary responsibility (though you must still monitor the delegate's behavior and performance).
- **No need to reinvent the wheel.**
 - There are “safe harbors” – actions which are deemed prudent, if specified conditions are met.
 - IRS has approved processes and methods to fix the most common errors (“EPCRS”).

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