“SO YOU THOUGHT THE 21st CENTURY COMPANY RETIREMENT PLANS WERE UNDER CONTROL?

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The following case illustrates three key principles, or learnings, for today’s participants to take away from the hypothetical Board discussion about 21st Century Company’s qualified retirement plans and related risk management issues:

* Number One. The Board is a “fiduciary” with regard to the Plans, and is subject to the highest standard of legal conduct. Each Board member is also subject to personal liability for breaches of fiduciary duty or engagement in a prohibited transaction. “Fiduciary” is a highly-regulated and complex status under the Employee Retirement Income and Security Act of 1974 (“ERISA”), the federal pension law.
* Number Two. Significant and numerous Plan administration and Plan investment issues are deemed to be fiduciary functions, and must be identified, analyzed and resolved as such.
* Number Three. A Board may undertake numerous strategies and governance structures to mitigate Board-level ERISA fiduciary liability and delegate it to a more appropriate risk center.

**THE CASE: Fiduciary Liability Review of 21st Century Company Retirement Plans**

21st Century Company is the holding company for numerous subsidiaries involved in the financial services and related technology/software industries. It maintains a 401(k) Plan for the 3,500 plus employees currently working at its four (4) wholly owned original subsidiary companies, and a 401(k) Plan, a Profit Sharing Plan, and a Defined Benefit Plan (all together, the “Plans”) respectively for its most recent three acquisitions – each of which is owned 80% or more by 21st Century. It also has a minority interest (less than 50%) in a manufacturing subsidiary where the acquired company (a print company) participates as an employer in the United States States Steel Workers Union Plan – its employees are union members. 21st Century is currently engaged in a bid process to become the sole owner of this printing company.

Marcia L. Eagle is the new General Counsel of 21st Century. She brings excellent experience from service in both private and publicly held companies, which were all robust in terms of offering various employee benefit /retirement programs and were supported by cutting edge internal legal counsel and HR personnel. Marcia is concerned, although not necessarily surprised, about the informal governance structure surrounding the Plans and the low priority to which the Board has assigned the Plans’ importance. In fact, as part of her interview process for her position several months earlier, she had been confidentially told by a senior Board member that “perhaps we need to look at the retirement plans anew from a liability perspective. We spend so much time on strategy and the business and the stock price that we sometimes don’t pay attention to other areas”. Apparently, a string of Wall Street Journal articles over the preceding years had finally caught his attention. The culture of 21st Century at both the management and Board level, however, remained very much enamored of stock and stock options and quarterly earnings and viewed the Plans as a necessary part of doing business and retaining/hiring employees.

Marcia, with the approval of the CEO, immersed herself in the Plans’ history and operations, the division of responsibilities undertaken internally at 21st Century and by outside financial consultants, the vendor contracts, Plan documentation, and of course, the Board minutes.

She is going to raise the following points at today’s Board meeting:

1. The Board has significant fiduciary liability with regard to the administration and the investment aspects of the Plans.

* The Plan documents each name the Company as the Administrator and as the Named Fiduciary. First Global Bank (which also provides the lead banking line of credit) is a passive, directed trustee with virtually no powers or authority beyond that required by state trust law.
* There is no internal Administrative Committee, Investment Committee, or Plan Committee.
* Various executives from Finance, Treasury, Legal and HR Departments handle day to day administrative and investment matters under no formal guidance or direction.

In other words, the Board has significant de facto authority and responsibility with little oversight or control.

2. Long Term Returns, Inc., the financial firm that has helped to establish the Plans, answers questions, and conducts annual meetings with employees, charges an asset management fee for “doing it all”. The fine print, however, severely limits the nature and level of legal liability assumed by Long Term.

3. The funds available in the Plans are of different share classes, and have varying internal operating expenses. Some pay 12b-1 or other forms of revenue sharing, others do not. Approximately half of the Funds are offered by a Long Term affiliate.

4. Marcia has also noted many instances over the preceding 5 years where there have been questions about the Plans with uncertain outcomes. For example, there have been questions about the timing of 401(k) deposits, the resolution of QDROs from different states, the availability of 401(k) loans or hardship withdrawals, and the overall “fairness” of the benefits provided under each of the Plans vis-a-vis the other.

Marcia is going to suggest that:

1. The Plan formally engage an investment adviser.
2. The Plan formally engage a plan administrator.
3. 21st Century procures ERISA fiduciary insurance.

The Board now moves to a discussion of these recommendations.