

Company Stock in 401(k)'s? Hello, Independent Fiduciary

Evercore Trust on potential benefits of obtaining outside guidance

By **Daniel Schatz**,
Regional Director, Dimensional Fund Advisors



JUSTIN WISER, CFA,
is a financial analyst and
Senior Vice President in the
Washington, DC, office of
Evercore Trust Company.
Evercore oversees more than

\$25 billion in company stock fund assets held within various client 401(k) plans. Wiser earned a BA in economics from the University of Virginia and an MBA from the University of North Carolina at Chapel Hill. We talked with him about Evercore's views on the legal implications of using company stock in DC plans.

As scrutiny climbs about investing in company stock in a DC plan, can you address trends resulting from new legislation or judicial actions?

JUSTIN WISER: From a legislation standpoint, we really haven't seen any recent changes that affect company stock funds in 401(k) plans. What we have seen is a wave of new litigation since the Supreme Court's 2014 *Dudenhoeffer* decision, which altered the ERISA framework for oversight of such funds. We believe the trend in recent cases supports the model of outsourced management of company stock funds by an independent fiduciary. And different surveys show an increasing number of plan sponsors are heading in that direction.

Why should a plan sponsor be concerned about offering company stock within their DC plan?

WISER: One reason is litigation risk. Company stock funds have been subject to hundreds of "stock drop" cases over the years. *Dudenhoeffer* has increased the risk of litigation as plaintiffs test the new legal standard. In our view, the *Dudenhoeffer* standard appears to be more difficult to navigate if employees, who may have access to nonpublic information, are also in the role of deciding whether or not it is prudent to continue offering a company stock fund.

The opinions expressed herein represent the personal views of Evercore Trust and not those of Dimensional Fund Advisors LP or its affiliates and are subject to change continually (including due to changes in the law) and without notice of any kind. This article is offered only for general informational purposes; it does not constitute invest, tax, or legal advice, and should not be relied on as such. You should not act or rely on any information contained in this article without first seeking the advice of an attorney. Dimensional makes no representations as to the accuracy of, and assumes no duty to update, the information provided herein.

Another key concern is the difficulty of establishing an appropriate internal process for monitoring the fund. There are also potential conflicts to address. Many investment consultants advising a company on its plan will not provide advice regarding the stock fund, either.

How might appointing a service provider help to reduce or mitigate plan sponsor liability?

WISER: The appointment of an independent fiduciary may mitigate the risk of litigation focused on internal fiduciaries' actual or implied access to material nonpublic information—and can help establish a prudent, well-documented process of fiduciary oversight of the fund. The appointment puts the fund on similar footing with other plan investment options that already have a professional investment manager and reduces demands on company and committee resources.

Participants can benefit from unconflicted oversight of the fund by an experienced professional with specialized financial and fiduciary expertise. The independent fiduciary is often in a better position to communicate with participants and, if necessary, to take action on behalf of the participants.

What are some common misconceptions about appointing an independent fiduciary?

WISER: One is the circumstances under which an independent fiduciary might choose to restrict or eliminate a company stock fund. We believe there are very limited circumstances where the law requires an independent fiduciary to take such action. Sponsors and their plan committees should confirm, however, that an independent fiduciary has a clear understanding of the applicable law and can delineate when they would consider taking action.

Another misconception is the cost. Typically, the cost is far less than that of other plan investment options. Appointing a third party can also save significant internal resources that would otherwise be devoted to monitoring and oversight of the fund. Finally, fees can generally be paid to an independent fiduciary either by the sponsor or from plan assets as a permissible expense of plan administration.

What actions can an independent fiduciary take with respect to company stock?

WISER: The responsibilities of an independent fiduciary depend upon the investment management agreement. Generally speaking, an independent fiduciary is responsible for determining on an ongoing basis that the company stock

fund remains a prudent investment option under ERISA and whether or not to keep the fund open to participants. In doing so, the independent fiduciary typically has a number of tools. Initial steps could include enhanced monitoring of the company stock fund, both internally and with the help of outside experts. An independent fiduciary could choose to send additional communications to participants, reminding them of the risks and of their own responsibility for deciding whether or not to invest.

In the extraordinary event that an independent fiduciary's analysis led them to believe they were required under ERISA to take more serious action, they could move to prohibit new investment in the fund or to liquidate the fund altogether.

Does appointing an independent fiduciary completely relieve a plan sponsor of all liabilities surrounding offering company stock in a DC plan?

WISER: No arrangement will completely relieve a plan sponsor of all liability. We do believe, however, that the primary responsibility a sponsor retains when they delegate responsibility to an independent fiduciary is to monitor the fiduciary to determine that they remain qualified to perform their role.

How should plan sponsors evaluate potential service providers offering independent oversight and monitor those providers over time?

WISER: First, a plan sponsor needs to think through the decision to hire an independent fiduciary. Handing control of the fund to an outside party is a new concept for many, so it is typically done with the help of ERISA counsel, an investment consultant, and/or the service providers.

Evaluating an independent fiduciary looks a lot like the due diligence one conducts on a traditional asset manager, reviewing the firm, its experience, process, people, etc., and its understanding of the appropriate legal framework for the role. A sponsor may choose to conduct an RFP, which has become increasingly common in our experience.

The sponsor has an ongoing duty to monitor the independent fiduciary, as they do with any investment manager. We typically meet with clients at least once a year and have a regular dialogue with them about the account and any changes in the legal environment.

© 2017 Dimensional Fund Advisors. Reprinted from DC Dimensions Winter 2017.

This information is intended for registered investment advisors and institutional investors.

The views and opinions of the third-party authors do not necessarily represent the views of Dimensional Fund Advisors. The articles are distributed for informational purposes only and should not be considered investment, tax, or legal advice or an offer of any security for sale.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

To read other articles from the magazine or for more information about Dimensional's DC services, please visit us at us.dimensional.com/defined-contribution.