FIDUCIARY BEST PRACTICES PART I: ESTABLISH A FIDUCIARY COMMITTEE TO GET YOUR PLAN IN ITS BEST FIDUCIARY FORM

By Alston & Bird LLP Health Benefits Practice

Lawsuits aimed at welfare plan fiduciaries are on the rise, with two filed against large, self-insured plans in the last six months related to the high cost of prescription drugs. The complaints in these lawsuits make several allegations against plan fiduciaries, including breach of the duties of prudence and loyalty that led to the alleged mismanagement of prescription drug benefits, as well as accusations of prohibited transactions for paying unreasonable fees to pharmacy benefit managers (PBMs).

The outcome of these lawsuits is uncertain, and the plan fiduciaries have a number of defenses, but as these lawsuits progress, the actions of those exercising discretion and management over the prescription drug benefits will be scrutinized, and plan fiduciaries could be deposed.

Do you know who the named fiduciaries are for your company's welfare plan? If your plan documents simply designate the "plan sponsor" or "plan administrator" as the named fiduciary without further formal designation or delegation, it is possible that your board of directors could be named in a lawsuit, and any one of them could end up being questioned over how you negotiated the arrangement with your PBM.

If these lawsuits signal the start of a trend of more to come, then plan sponsors will need to make sure their plan has a BFF—best fiduciary form. In this month's article, we discuss the first steps to get your plan in its best fiduciary form by establishing a fiduciary committee that reports to your organization's top benefits leadership, as well as the establishment of a prudent review process to monitor your current plan service providers. Next month, we will follow up with best practices for selecting a service provider and analyzing the reasonableness of fees. But first, what exactly are these fiduciary duties, and who is performing fiduciary functions for your plan?

This litigation trend is coupled with increased scrutiny by the Department of Labor (DOL). Ten years ago, DOL investigations were almost exclusively limited to retirement plans. Now, DOL officials relate that almost half of their investigations are group health plans and may become more than half in the coming years. Those investigations often focus on Mental Health Parity and Addiction Equity Act (MHPAEA) compliance and also added obligations under the Consolidated Appropriations Act of 2021 (CAA).

WHAT ARE THE CORE ERISA FIDUCIARY DUTIES?

The Employee Retirement Income Security Act of 1974 (ERISA) imposes a duty of prudence and a duty of loyalty on fiduciaries, as well as an implied duty to monitor service providers to whom fiduciary responsibilities have been delegated. The duty of prudence requires a fiduciary to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent [person] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise with a like character and with like aims."

Notice that the focus here is on the process, not on the outcome. The duty of loyalty requires fiduciaries to act solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to them. Fiduciaries can delegate some of their responsibilities to service providers, but fiduciaries have an ongoing duty to monitor those service providers and to replace the ones that are no longer serving the best interests of the plan or its participants.

Note: Settlor functions and fiduciary functions are distinct. Plan sponsors have no ERISA fiduciary liability for carrying out settlor functions. Examples of settlor functions include establishing a plan, plan design (e.g., eligibility, benefits, and employee contribution amounts), how to fund a plan, plan amendments, and terminating the plan. The distinction is not always clear. For example, if a group health plan document is amended to formally name a provider network, is that designation a settlor function? DOL's likely position would be that network selection remains a fiduciary function even if "hardwired" into the plan document.

WHO IS AN ERISA FIDUCIARY?

An ERISA fiduciary is someone who exercises discretionary authority or control over the plan, whether that be over the management of the plan, the disposition of plan assets, or investment advice (e.g., for VEBAs that have an investment component). This is true whether the person was named or designated as an ERISA fiduciary or whether the person just functions as an ERISA fiduciary by virtue of the person's level of control over the plan or its assets or by virtue of position. The plan administrator, for example, is always an ERISA fiduciary, according to the Department of Labor (DOL). However, if the plan administrator isn't defined in the plan documents, the plan sponsor (i.e., the company in most instances) is the default plan administrator.

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BEST PRACTICES: ESTABLISH A FIDUCIARY COMMITTEE FOR THE HEALTH & WELFARE PLAN

ERISA fiduciaries have personal liability for breaches of their fiduciary duties. But even before any liability is imposed, a lawsuit filed for a breach of fiduciary duty will expose the plan fiduciaries to scrutiny, including depositions about the details of plan administration, reasonableness determinations for service provider fees, and how the plan monitors those service providers. If your plan is like many other self-insured ERISA welfare plans, the plan document likely names the plan sponsor or the employer as plan administrator without much more.

The board of directors, managers, or partners could end up as the default plan sponsor/employer for corporations, limited liability companies, and partnerships (respectively), and few, if any of them, are likely to have much detailed knowledge about how the plan is administered or managed. Plans can avoid these scenarios by properly establishing a fiduciary committee to serve as plan administrator, thereby limiting (though perhaps not eliminating entirely) the exposure of the organization's top leadership to litigation. Proper committee establishment will require diligent planning and a clear intent.

- **Document formal establishment.** Given the gravity of ERISA fiduciary status, plan sponsors will need to clearly document the establishment of the committee, starting with the corporate/entity formalities for similar actions (e.g., a Board vote, a resolution signed by corporate officers, etc.)
- **Identify and delegate**. The plan sponsor will need to identify the members of the committee, either by position, job title, name, or some other method of identification. Identification by position or job title may reduce the frequency of updating the governing instruments so long as successors to the position are fully trained in their fiduciary duties. You will want the members of the committee to acknowledge their fiduciary status in writing. This is especially important when there is a designation by job title and turnover in that job title. It is important that the committee members have substantive knowledge of at least some aspects of welfare plans.

- **Consider a committee charter.** A committee charter can provide even more clarification of the responsibilities delegated to the committee and specify any limitations on committee authority. The charter can also describe how the committee will delegate authority, what procedures it will follow for selecting and monitoring service providers, and to whom the committee reports. If the committee performs any settlor functions (such as amending the plan), it is important to detail those functions in the charter and make clear that they are settlor functions and not fiduciary functions.
- **Hire Experts.** While next month's article will discuss the selection of service providers, it may be necessary to hire experts to monitor existing service providers where the committee lacks expertise. For example, committee members likely do not have the expertise to compare the competitiveness of pricing for a plan's prescription drug formulary (one of the subjects of current litigation) or the depth of a plan's network of mental health and substance use disorder providers (the subject of DOL investigations).
- **Schedule routine meetings.** Like any other committee with oversight functions, routine meetings, preferably that include key advisors like in-house or outside counsel and benefit consultants, can keep ongoing duties (like monitoring service providers) on the front burner and keep committee members up-to-date on any recent changes to the compliance landscape Keep minutes of committee meetings.
- **Maintain a compliance calendar.** Health and welfare plans have numerous deadlines throughout the year. Creating a compliance calendar will keep the committee on track and avoid unnecessary (and expensive) failures.
- **Train fiduciaries.** Train fiduciaries on key responsibilities related to their fiduciary duties, such as selecting and monitoring a service provider, reviewing fees, and ensuring that service contracts comply with applicable law. Fiduciaries should also be able to identify when an arrangement with a service provider could raise prohibited transaction red flags.

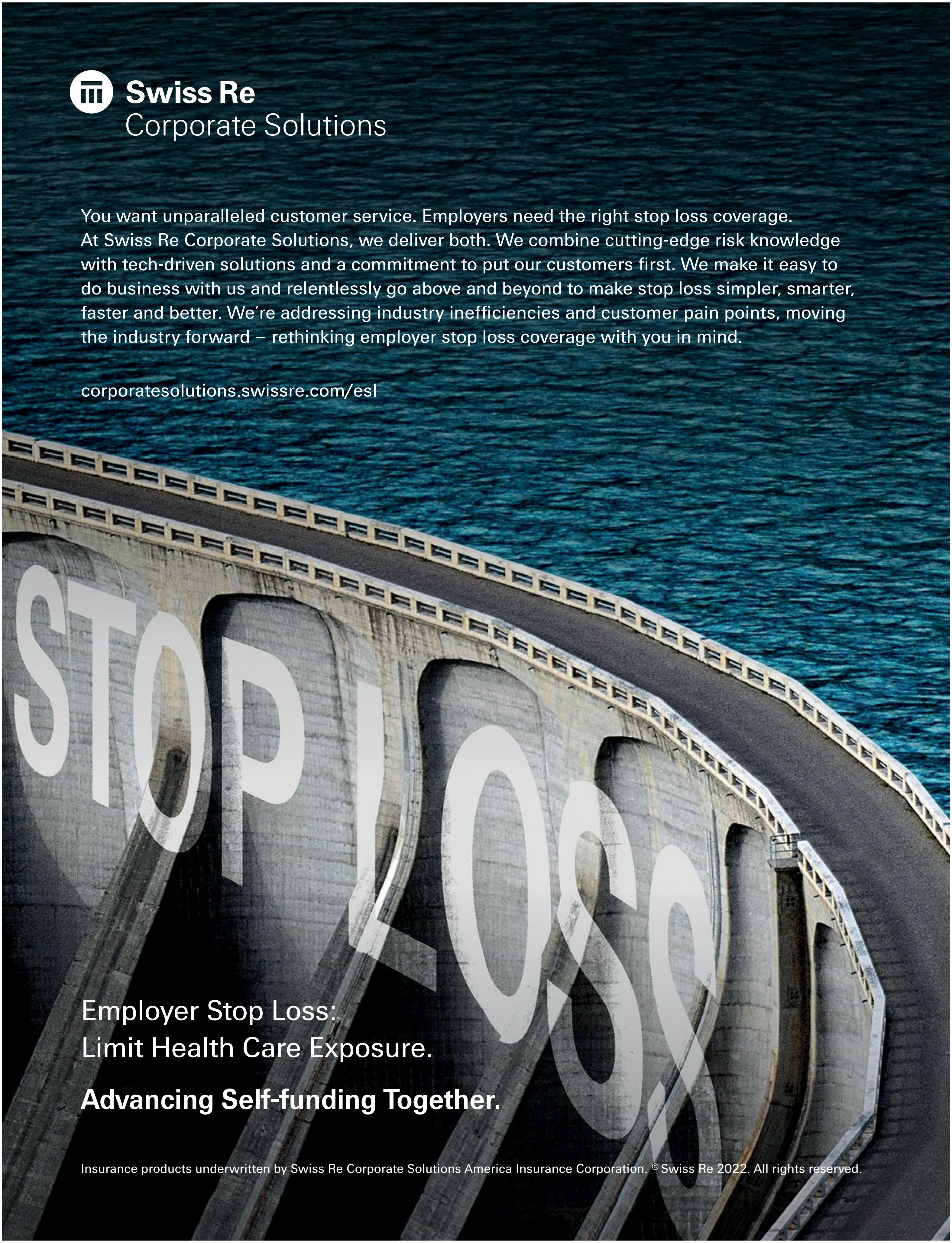
BEST PRACTICES: COMMITTEE BASICS

Newly formed fiduciary committees—and even existing committees that have been dormant with respect to anything other than day-to-day responsibilities—should conduct a general fiduciary compliance review to level-set and identify risks that need to be addressed. This is easier said than done and will take some time. Key topics to include on the punch list include (there are certainly several other topics we could include here):

- **Plan document hygiene.** Obtain and review all the current plan documents for compliance, updates, and amendments—e.g., wrap plan document and summary plan description, cafeteria plan document, HIPAA policies and procedures, COBRA documents, summaries of benefits and coverage. Are your plan documents current for MHPAEA and CAA (including the No Surprises Act)? Are you updating your SPD timely, or are the summaries of material modifications stacking up?
- **Testing and other Analyses**—Have you performed MHPAEA quantitative treatment limitations testing? Do you have an MHPAEA nonquantitative treatment limitations comparative analysis? Have you done Internal Revenue Code (Code) non-discrimination testing on your self-insured medical plan? What about non-discrimination testing on your cafeteria plan, where there are typically nine different non-discrimination tests when you have health and dependent care flexible spending accounts?

- **Disclosures.** Make sure your annual disclosures are compliant and timely (e.g., CHIPRA, HIPAA, Medicare creditable coverage, COBRA, posting machine-readable files, prescription drug reporting, and gag clause attestation). Also, check your distribution methods for electronic disclosure of SPDs, HIPAA notices of privacy practices, and other documents subject to electronic disclosure rules. Are you getting consent for electronic delivery from employees who do not access a computer as part of their routine job duties?
- **Service Providers.** Obtain all plan service providers agreements and check for market standard provisions, fees, and proper delegation of fiduciary responsibility. Are you reviewing agreements for gag clauses, fee disclosure language, early termination penalties, and other compliance issues? The CAA has specific fee disclosure requirements for brokers and consultants and puts the burden on plan fiduciaries to review those disclosures as well as take action if they have not been received. Have you received those disclosures and reviewed them?
- **HIPAA/Cybersecurity.** Review your HIPAA policies and procedures and make sure they are up-to-date. Have you updated your HIPAA policies and procedures yet for the recent reproductive healthcare final rule (required by December 23, 2024)? Check with your IT department on your cybersecurity protocols.

In addition to these basics, the trend in litigation necessitates that committees focus on developing a prudent process for selecting and monitoring your service providers. This month, we address best practices for monitoring your existing providers; next month, we will address best practices for selecting a new service provider.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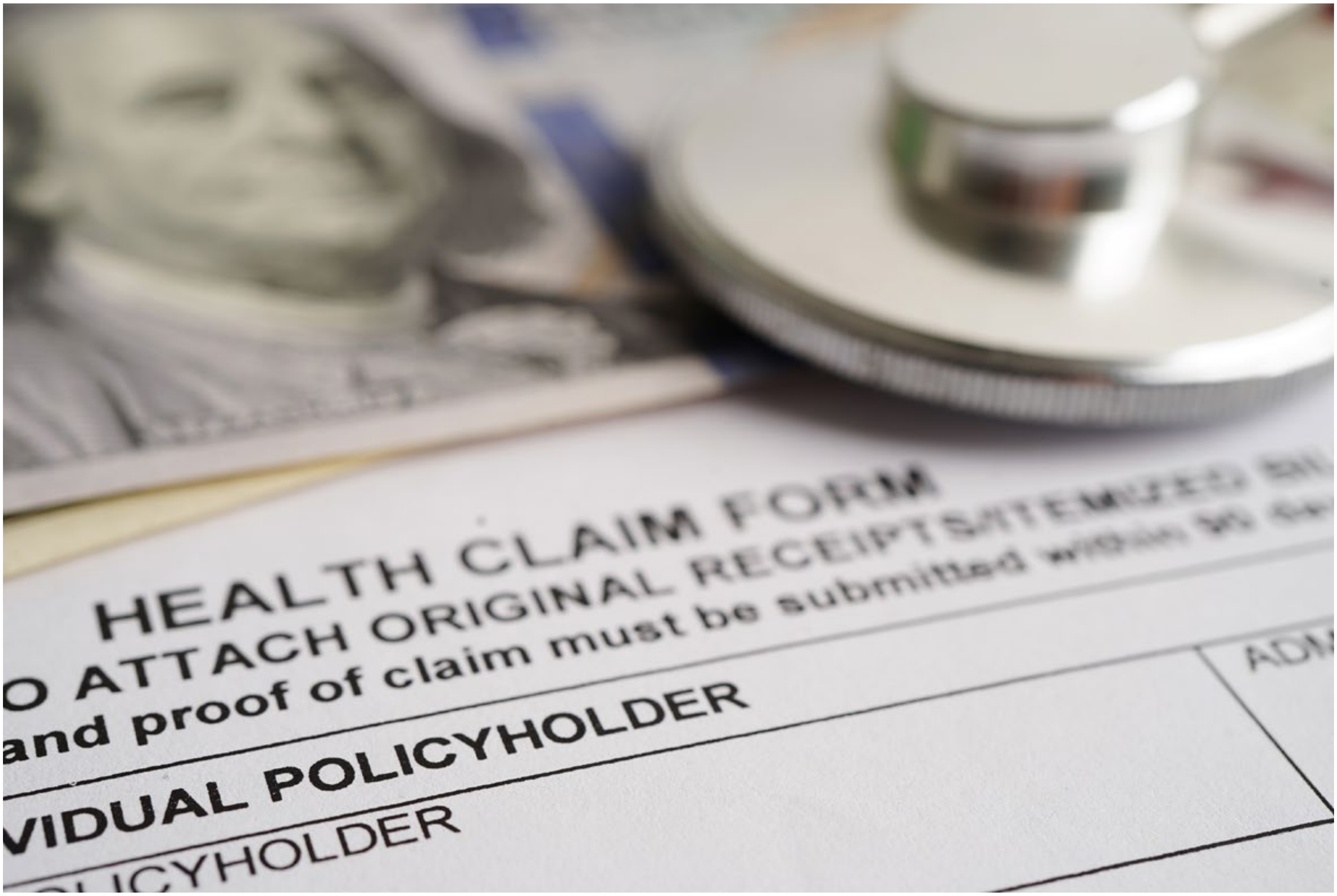
BEST PRACTICES: MONITORING THE SERVICE PROVIDER

One of the allegations in a recently filed lawsuit against a health & welfare plan involves failure to have a prudent process for monitoring PBMs with respect to drug pricing. Whether this allegation holds up through the early stages of litigation remains to be seen, but for now, plan fiduciaries should be examining their formal review process of service providers. Conduct and document reviews at routine (or at least reasonable) intervals, including the reasoning behind deciding to keep or replace a current provider. Keep in mind that these reviews may be used to defend fiduciaries against allegations of whether they failed to monitor service providers, so include any follow-up action, such as whether the service provider remedied a shortcoming or adjusted fees.

When monitoring service providers, fiduciaries should take action to ensure the providers are performing the agreed-upon services. Fiduciaries should, at the very least, consider:

- **Reviewing the service providers' performance.** Is the service provider actually doing all that they agreed to and meeting your expectations? Are their employees properly trained and qualified for the responsibilities you have delegated to them? Did the service agreement include performance guarantees? How close does the provider come to meeting them?
- **Reading any reports the service provider prepares for the plan.** It isn't enough to file the report for recordkeeping purposes. Review reports provided by the service provider and seek advice or counsel if you don't understand something or have any concerns. Make sure you understand the report and whether any changes need to be made to the plan or to its administration. Also, what kind of reports does the service provider generate for you as part of the agreement, and which reports require an extra fee? Are you receiving all the reports that you expected to receive? Do you have claim or other audit rights? If so, when was the last time you performed such an audit?



- **Checking actual fees charged.** Review and analyze the types of fees/compensation in an agreement and compare to what the plan has been charged—for example, PEPM, % of savings, % of recovery, payments from third parties (rebates, service fees, etc.), and payments to third parties (subcontractor fees). Ask questions if something doesn't add up.
- **Asking about policies and practices.** For example, ask your TPA about their claims processing systems, ask to see templates of claims review letters, ask about the use of artificial intelligence, and ask about provider payment rules.
- **Ensuring proper maintenance of plan records.** A recordkeeping system should, for example, track contribution and benefit payments, maintain participant and beneficiary information, and accurately prepare reporting information.
- **Following up on participant complaints.** If participants complain about a particular service provider, fiduciaries should document the complaint and follow up.

Another important consideration when monitoring service providers is whether the committee has delegated any discretionary authority to the provider itself. Plan fiduciaries can delegate fiduciary responsibilities but can never delegate fiduciary liability. If the service provider is carrying out the functions of a fiduciary, consider these additional precautions:

- **Use prudence when selecting the provider.** The delegating fiduciary must act prudently in TPA/claim fiduciary selection and monitor TPA's performance. We will discuss best practices for selecting service providers in next month's article.

- **Delegate in writing.** Clearly delegate claim fiduciary responsibility to a TPA in writing. Even if this is not required by the plan, it's an important practice to clearly identify which providers have fiduciary status. Make sure that "Firestone language" (i.e., providing discretionary authority to decide claims) is tied to any TPA or other vendor that is making claims decisions, and that language appears in both your plan document and SPD.
- **Treat the service provider's breach as if it were your breach.** If the committee, as the delegating fiduciary, becomes aware that a service provider has breached its fiduciary responsibilities, the committee will be liable for that breach unless the committee takes steps to remedy the breach or ensures that the service provider cures the breach.

FIDUCIARY LIABILITY INSURANCE

Even the most diligent fiduciaries could be the target of lawsuits. Some plan sponsors overlook fiduciary liability insurance for health & welfare plans—make sure you aren't one of them. Even though ERISA prohibits a plan or sponsor from indemnifying plan fiduciaries, fiduciary liability insurance is permitted. This coverage usually includes coverage for breach of fiduciary duty, management negligence, specific IRS and DOL penalties, and voluntary compliance sanctions, but it may also include coverage for pre-claim defense costs and challenges to settlor functions.

Generally, this kind of insurance will not cover criminal acts, which fall under the ERISA fidelity bond. (Note that fiduciary liability insurance is not the same as ERISA bonding insurance.) It also won't cover intentional violations of ERISA (but may include defense costs) or third-party fiduciaries. The size of your plan, the scope of the coverage you choose, and even the plan's choice of service providers can all affect the pricing of fiduciary liability insurance. Having the safeguards and processes in place, like the ones we discuss here, may also be relevant. If your company tells you that it already has fiduciary liability insurance, ask to see the policy to make sure that the health & welfare plan's fiduciary committee is on the policy.

WHAT'S NEXT?

You've established a fiduciary committee and have monitored your service providers, but you found some of them to be lacking. What are some best practices for selecting a new service provider? How can a fiduciary show that it uses a prudent process for determining whether fees are reasonable? We will pick up those BFF issues in next month's article. In the meantime, make sure your plan and the leadership of your organization are protected by taking steps to:

- Identify the plan's fiduciaries
- Properly establish a fiduciary committee
- Conduct a fiduciary review to identify risks or compliance failures
- Obtain fiduciary liability insurance
- Monitor service providers and document the review process

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