Benefits Briefing: Company Stock as a Retirement Plan Investment

Friday, September 21, 2018
2 p.m. to 3 p.m. ET
Today’s Speakers

 Moderator:  
Jan Jacobson  
Senior Counsel, Retirement Policy  
American Benefits Council

Guest Speakers:  
John Matelis  
Chief Financial Analyst  
Newport Trust Company

Marc Sciscoe  
Partner  
Ice Miller LLP
Overview

Company stock has been a prominent investment in retirement plans sponsored by U.S. corporations for decades.

Recent developments have prompted plan committees to revisit company stock:

- Investment Rationale
- Legal Framework
- Risk Management
- Plan Sponsor Activities

This webinar will focus on company stock holdings within:

- Defined Contribution (DC) Plans
- Defined Benefit (DB) Plans
Defined Contribution Plans

- Brief history of company stock in DC plans
- Reasons to offer a company stock fund as an investment option
  - Promote employee ownership
  - Offer unique risk/return profile
  - Tax advantages
- Fiduciary responsibilities and legal risks
  - Prudent process to monitor
  - Stock drop litigation
  - Post-Dudenhoeffer case law
Company stock continues to be a core investment option within defined contribution plans sponsored by publicly traded members of the Council.

Council Members By Type
- Public: 58%
- Not for Profits and Law Firms: 24%
- Private: 18%

Council Public Members - DC Plans
- With Company Stock: 74%
- Without Company Stock: 24%
- Excluded*: 2%

* Excludes four members that are newly independent and have not filed Form 5500s or participate in another member’s DC plan.
182 Council public members sponsoring DC plans with company stock:

- Total plan assets of ~$1.12 trillion
- Total company stock of ~$189 billion
- Average and median company stock balances of ~$1 billion and ~$300 million, respectively
- Average concentration of 14.8% of plan assets
Market Research

Council Public Members Sponsoring DC Plans with Company Stock

Size of Company Stock Fund (in Millions) vs. Percentage of Plan Assets
Legal Framework

General Fiduciary Duties (ERISA Section 404(a))

- Loyalty
- Prudence
- Diversification
  - Exception for investment in qualifying employer securities
- In accordance with plan documents

ERISA Section 406 prohibits

- Sale or exchange of property between a plan and a party in interest
- Acquisition, on behalf of the plan, of any employer security in violation of ERISA Section 407(a)
Legal Framework

Prohibitions/Limits under Section 407(a)

• Prohibits investment in any:
  o employer security that is not a qualifying employer security, and
  o employer real property that is not qualifying employer real property

Definition of Eligible Individual Account Plan

Definition of Qualifying Employer Security
Legal Framework

Exemption under Section 408(e)

- Permits plan purchase or sale of qualifying employer securities
- For adequate consideration
- If no commission is paid with respect to the purchase/sale

Availability of Individual Exemptions
Legal Framework

Addressing the statutory tension

• The Moench presumption (Moench v. Robertson (3rd Cir. 1995))
• Presumption of reasonableness
• Somewhat differently applied in different jurisdictions

Fifth Third Bancorp. v. Dudenhoeffer (S. Ct. 2014)

• No presumption of reasonableness under ERISA
• Pleading of claim based on publicly available information
• Pleading of claim based on insider information
Legal Framework

- Post Dudenhoeffer Litigation
  - *Pfeil v. State Street Bank & Trust* (6th Cir. 2016)
  - *In Re Wells Fargo ERISA 401(k) Litigation* (D. Minn. 2018, currently on appeal to 8th Cir.)

- Additional Requirements under Internal Revenue Code
- Securities Law Considerations
Risk Management

Plan Design
- Plan Language
- ESOP Designation
- Cash Match
- Participant Caps
- Freeze Stock Fund
- Managed Accounts

Plan Governance
- Settlor v. Fiduciary Functions
- Fiduciary Charter/Designation
- IPS
- Prudent Process
- Fiduciary Training
- Formal Review

Other Actions
- Internal Oversight
- Participant Communications
- Targeted Outreach
- Insurance
- Investment Advisor
- Independent Fiduciary

Eliminate Risk
- Sunset a Company Stock Fund

DC Plans
Defined Benefit Plans

Reasons to contribute company stock to a defined benefit pension plan

- Improve funded status
- Offset future required contributions
- Conserve cash
- Investment return

Key considerations

- Economic tradeoffs and corporate priorities
- Market factors and tax treatment
- Pension funding, investment and risk transfer strategies

Over the last 10 years, public companies have made at least 50 contributions of qualifying employer securities valued in excess of $15 billion
Legal Framework

Section 407 Limits

- Employer security must be qualifying employer security
- Fair market value of qualifying employer securities held by plan may not exceed 10% of the value of plan assets
- 25% of class limitation

In-kind contribution is a transaction between a plan and a party in interest

- Statutory Exemption Available
Legal Framework

- DOL may grant an individual exemption if -
  - administratively feasible
  - in the interest of plan participants and beneficiaries, and
  - protective of the rights of plan participants and beneficiaries
- Interested parties must receive notice and opportunity to be heard
- Fiduciary Considerations
- Corporate Considerations
Contributions other than Stock

- **Statutory exemption for qualifying employer real property**
  - Real property that is leased from the plan to the employer
  - A substantial number of geographically diverse properties
  - Suitable for more than one use

- **In-kind contributions of other assets require an individual prohibited transaction exemption**

- **Over the last 10 years, the DOL has granted 15 exemptions permitting in-kind contributions.**
  - Examples: private equity, stock, unimproved real property, promissory notes, preferred membership interests, U.S. treasuries, intangible assets, guaranteed investment contract
Contact Information

John Matelis  
Chief Financial Analyst  
Newport Trust Company  
(202) 471-3504  
john.matelis@newportgroup.com

Marc Sciscoe  
Partner  
Ice Miller LLP  
(317) 236-2178  
marc.sciscoe@icemiller.com