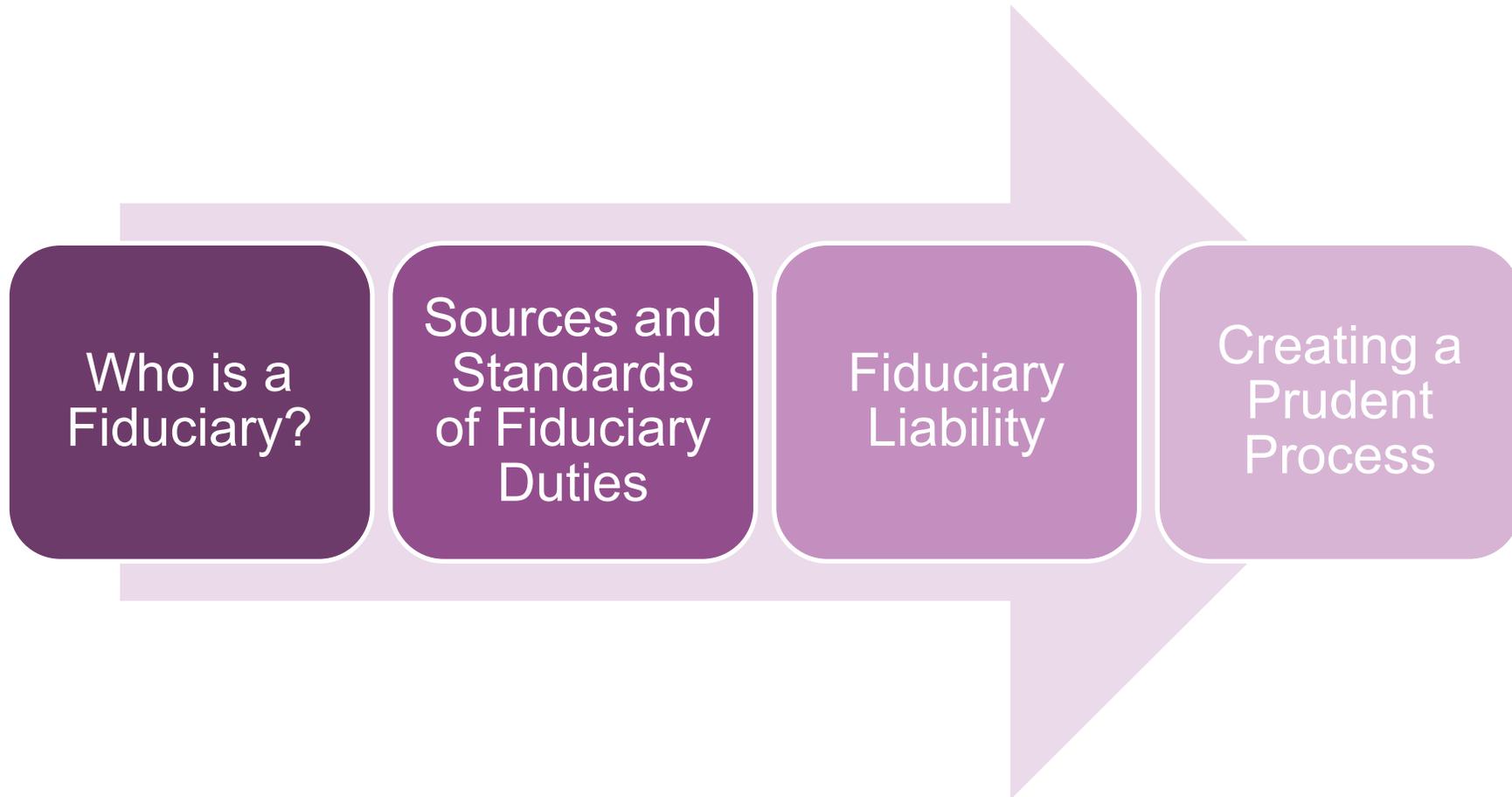


**build**  
*better benefits*

**San Francisco  
Health Service System  
Fiduciary Training  
Final**

**January 11, 2024**

# Agenda



# Who is a Fiduciary?

# Who is a Fiduciary?

An entity or individual may be a fiduciary either by **designation** or by **function**.

- Any person or entity who makes – *or has the authority to make* - discretionary administrative or investment decisions related to the Trust or the Plan.
- Any person or entity who is named in a Plan or Trust document as a fiduciary.
- Any person or entity who renders investment advice for a fee (e.g. investment advisor or consultant).

**Having authority to make a fiduciary decision makes you a fiduciary.**

# Typical Fiduciary Activities

Appointing other plan fiduciaries, *e.g.* investment advisors and managers

Delegating responsibilities to other fiduciaries

Selecting/monitoring trust investment vehicles

Acquiring/disposing of plan assets

Interpreting plan provisions

Making decisions under the plan such as adjudicating claims and appeals

# Who is a Fiduciary? (cont'd)

Plan Administrator

Trustees

Investment committee members

Administrative committee members

Investment managers

Investment advisors

Anybody else who performs fiduciary duties or who has responsibility for performing fiduciary functions

- Deciding claims.
- Interpreting plan documents.
- Human resources officers and finance officers can become **functional fiduciaries**.

# Who is not a Fiduciary?

Board or employer when acting in a **settlor** capacity = wears "two hats"

- Designing plan
- Amending plan
- Terminating plan

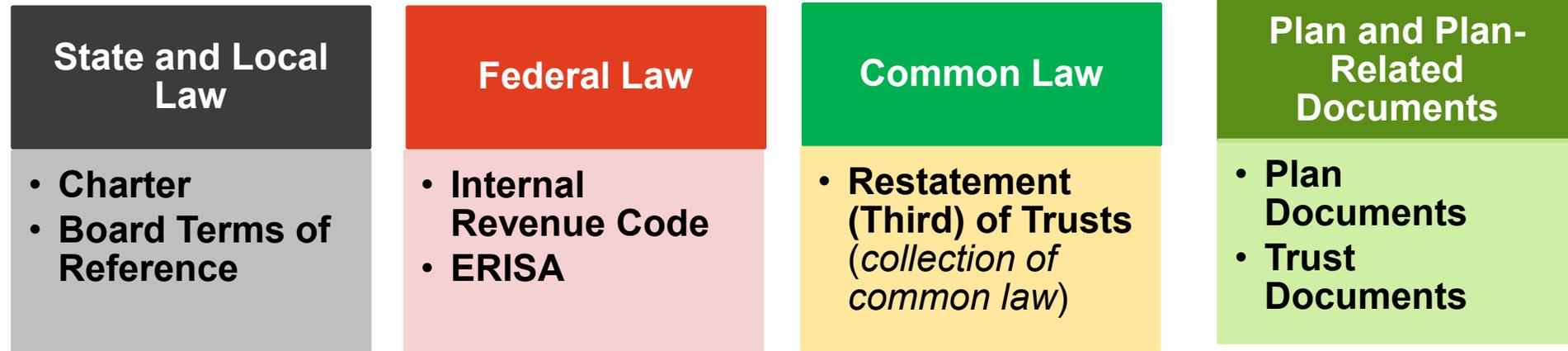
Attorneys, accountants, actuaries are not fiduciaries when acting in professional capacities.

Third party administrators or recordkeepers are not fiduciaries if solely performing ministerial functions.

# Breaking Down the Fiduciary Duties

# Sources of Fiduciary Duties

Fiduciaries are held to extremely high standards of conduct under the law.



# Charter Section 12.203

## HEALTH SERVICE SYSTEM FUND

The Health Service System fund shall be a trust fund administered by the Health Service Board in accordance with the provisions of this Charter solely for the benefit of the active and retired members of the Health Service System and their covered dependents. The City and County, School District and Community College District shall each contribute to the Health Service System Fund amounts sufficient to efficiently administer the Health Service System.

# Charter Section A8.429

## CONTRIBUTIONS TO FUND

The Health Service Board shall have control of the administration and investment of the health service system fund, provided that all investments shall be of the character legal for insurance companies in California. Disbursements from the fund shall be made only upon audit by the controller and the controller shall have and exercise the accounting and auditing powers over the health service system fund which are vested in him by this Charter with respect to all other municipal board, officers and commissions.

# Charter Section A8.423

## REVISION OF SCHEDULES AND COMPENSATION

The Health Service Board shall have the responsibility to obtain and disseminate information to its members with regard to plan benefits and costs thereof. All expenses in connection with obtaining and disseminating said information, the investment of such fund or funds as may be established, including travel and transportation costs, member wellness programs, actuarial expenses and expenses incurred to reduce health care costs, shall be borne by the system from reserves in the health service fund but only upon adoption of a resolution by the Health Service Board approving such expenses.

# Health Service System Board Terms of Reference (Approved April 9, 2015)

## Investment Administration

The Board shall administer the Health HSS Trust Fund in accordance with the provisions of the City Charter solely for the benefit of the active and retired members of the HSS and their covered dependents. [Sec. 12.203]

The Board shall have control of the administration and investment of the Health HSS Trust Fund, provided that all investments shall be of the character legal for insurance companies in California. [A8.429]

# Health Service System Board Terms of Reference – Investment Admin., Cont'd

In keeping with its fiduciary duty to prudently administer the Health Service Trust Fund, the Board shall be responsible for:

- Approving a written investment policy statement, and reviewing, confirming, or amending such policy at least annually;
- Ensuring qualified parties are appointed to manage the assets of the Health HSS Trust Fund;
- Ensuring regular compliance monitoring in regards to the investment policy statement; and
- Ensuring ongoing review of the investment performance of the Health Service Trust Fund.

# California Constitutional Standard for Pension Systems

Article 16, Section 17(c) of the California Constitution provides that the members of the board of a public pension system "shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims."

# California Uniform Prudent Investor Act (“UPIA”) Standard.

The UPIA standard requires that a fiduciary manage trust assets "as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust," and, in satisfying that standard, the fiduciary "shall exercise reasonable care, skill, and caution." The fiduciary must also diversify the investments of the trust unless the fiduciary reasonably determines that the purposes of the trust are better served without diversifying.

# Employee Retirement Income Security Act of 1974, ("ERISA") Standard

ERISA requires a fiduciary to act solely in the interests of the participants and beneficiaries of the plan and "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims."

This is essentially the same language from Article 17 of the California Constitution and is similar to the UPIA standard cited above.

# San Francisco Retiree Health Care Trust Fund – Board Terms of Reference – Par. 3

The Board shall discharge its duties with respect to the Fund with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person, acting in a like capacity and familiar with these matters, would use in the conduct of an enterprise of a like character and with like aims.

# Fiduciary Standards

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## Duty of Loyalty

Duty to act solely in the interest of participants and beneficiaries.

Duty to act for the exclusive purpose of providing benefits or paying reasonable plan expenses.

Duty to act independently and without conflicts of interest.

Duty to act impartially among differing interests.

## Duty of Prudence

Duty to act with care, skill, prudence, and diligence of prudent person familiar with like matters.

Duty to be informed.

Duty to delegate responsibilities outside of expertise.

Duty to diversify investments.

## Duty to Follow Plan Document

## Prohibited Transactions

No self-dealing.

Cannot pay unreasonable compensation for services performed.

# Duty of Loyalty



# Duty of Loyalty – Independence

- A fiduciary has a duty to act in the interest of the members and beneficiaries **as if there were no other competing interests to protect.**
  - Cannot act for fiduciary's own personal or business interest.
  - Cannot be influenced by the interest of any third person.
  - Must set aside the interests of the party that appoints the fiduciary.
- Requires **undivided loyalty** to participants and beneficiaries in the administration of the plan.
- Contrast with settlor decisions.

# Settlor vs. Fiduciary Functions: Two Hats

- Settlor (non-fiduciary) Functions
  - Establishing a plan
  - Amending a plan
  - Terminating a plan
  - Taking actions for a legitimate business purpose (even though they may affect the plan and its participants)
- Fiduciary Functions
  - Implementing settlor's plan designs
  - Administering a plan
  - Making discretionary decisions related to the plan or its funds
  - Investing plan funds

# Settlor vs. Fiduciary Functions: Two Hats

“Employers can be ERISA fiduciaries and still take actions to the disadvantage of employee beneficiaries when they act as employers (*e.g.*, firing a beneficiary for reasons unrelated to the ERISA plan), or even as plan sponsors (*e.g.*, modifying the terms of the plan as allowed by ERISA to provide less generous benefits.”

U.S. Supreme Court  
*Pegram v. Hendrich*

# Settlor vs. Fiduciary Functions: Two Hats

- Acosta v. Brain (9<sup>th</sup> Cir. 2018)
  - Trial court held that plan trustee breached fiduciary duty by putting employee on administrative leave allegedly to retaliate against her for cooperating in a DOL investigation of employer's health plan.
  - Court of Appeals reversed because “every business decision an employer makes can have an adverse impact on an employee benefit plan, but not all give rise to fiduciary concerns.”

# Settlor vs. Fiduciary Functions: Two Hats

- Examples of settlor decisions upheld by courts
  - Amending a pension plan to a formula that was not supported by the plan's current funding
  - Amending a pension plan to purchase annuities to de-risk the plan, even though it could put participants' benefits in a riskier position
  - Instituting a lump-sum window to de-risk a pension plan
  - Decision to fund a plan vs. to fund other corporate debts
  - Amending a plan that provided lifetime health benefits to transfer assets to a plan that did not
  - Conditioning an early retirement benefit on a waiver of all employment-based claims
  - Making time periods to sue a plan shorter than applicable statutes of limitations

# Settlor vs. Fiduciary Functions: Two Hats

- Eligibility and Benefit Designs are Settlor Decisions
  - Cannot violate other laws such as Title VII, ADA, ADEA, self-funded health plan nondiscrimination rules, etc.
  - Can generally draw lines between employees
  - Can generally offer different benefit plan to different employees
  - Can make differentiations between benefit options with respect to types of benefits, deductibles, copayments, coinsurance

# Duty of Loyalty – Impartiality

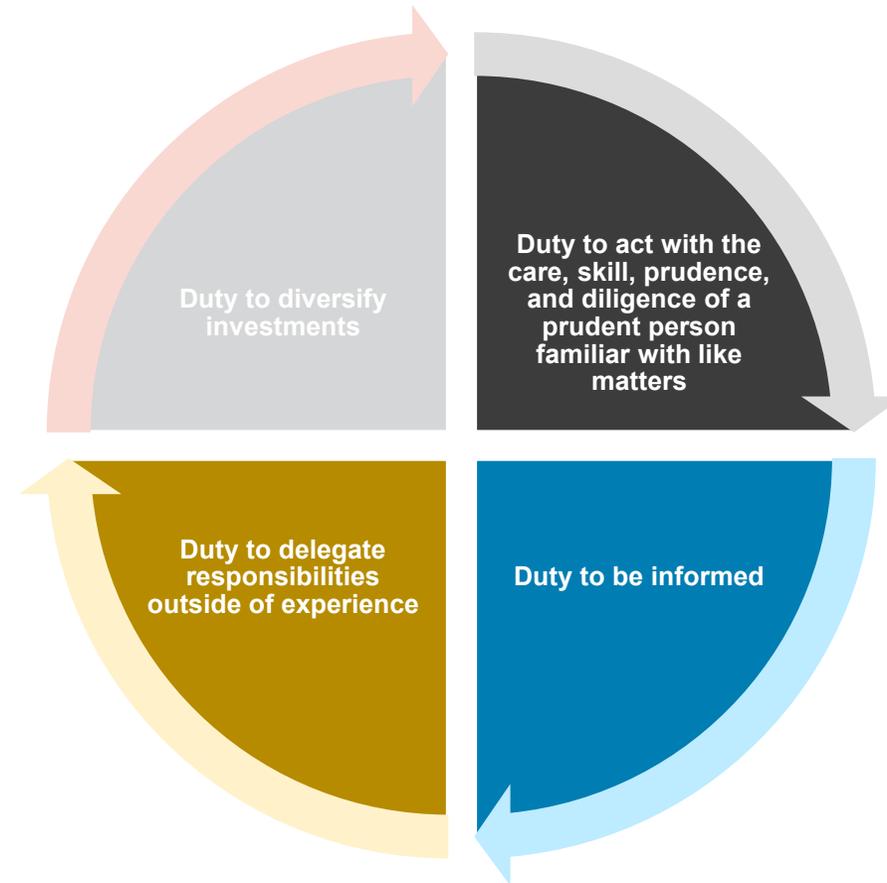
- A fiduciary owes a duty of loyalty to **all members and beneficiaries**, and respecting that duty requires the fiduciary to be **impartial among differing interests**.
  - Balance the interests of retirees, active and other distinct groups of participants.
  - Balance the interests of different types of participants.
  - Have to look at the “bigger picture” even if a decision adversely affects certain participants.

# Duty of Loyalty - Plan Expenses

A fiduciary shall discharge duties with respect to a plan incurring only costs that are appropriate and reasonable to administer the plan.

- Fee transparency.
- Understand what and how fees are paid.
- Only plan expenses can be paid from trusts.

# Duty of Prudence



# Duty of Prudence – Be Informed

The fiduciary has a duty to **be informed** with respect to the decisions they are required to make.

- Regularly attend meetings.
- Review materials provided at meetings.
- Request materials and ask questions to ensure adequate information before taking action.
- Be familiar with governing documents.
- Be familiar with general laws applicable to the plans.
- Secure and consider advice of expert on reasonable basis, **but exercise independent judgment.**

# Duty of Care – Delegation

A fiduciary can delegate functions that a prudent fiduciary acting in a like capacity and familiar with those matters could properly delegate.

A fiduciary has a duty to delegate responsibilities outside of the fiduciary's expertise.

Delegation should not be overly broad and must be consistent with duty of care and caution, *e.g.* terms of delegation must be prudent.

# Duty of Care – Delegation *(cont'd)*

Documentation should be clear and consistent

- Set out specific duties in writing.
- Require the delegate accepts all assigned duties.

Delegation is a fiduciary act

- Must delegate **prudently and in accordance with the written plan.**
- Must **monitor** the delegate.
- Fees and costs must be **reasonable.**

# Duty of Care – Delegation *(cont'd)*

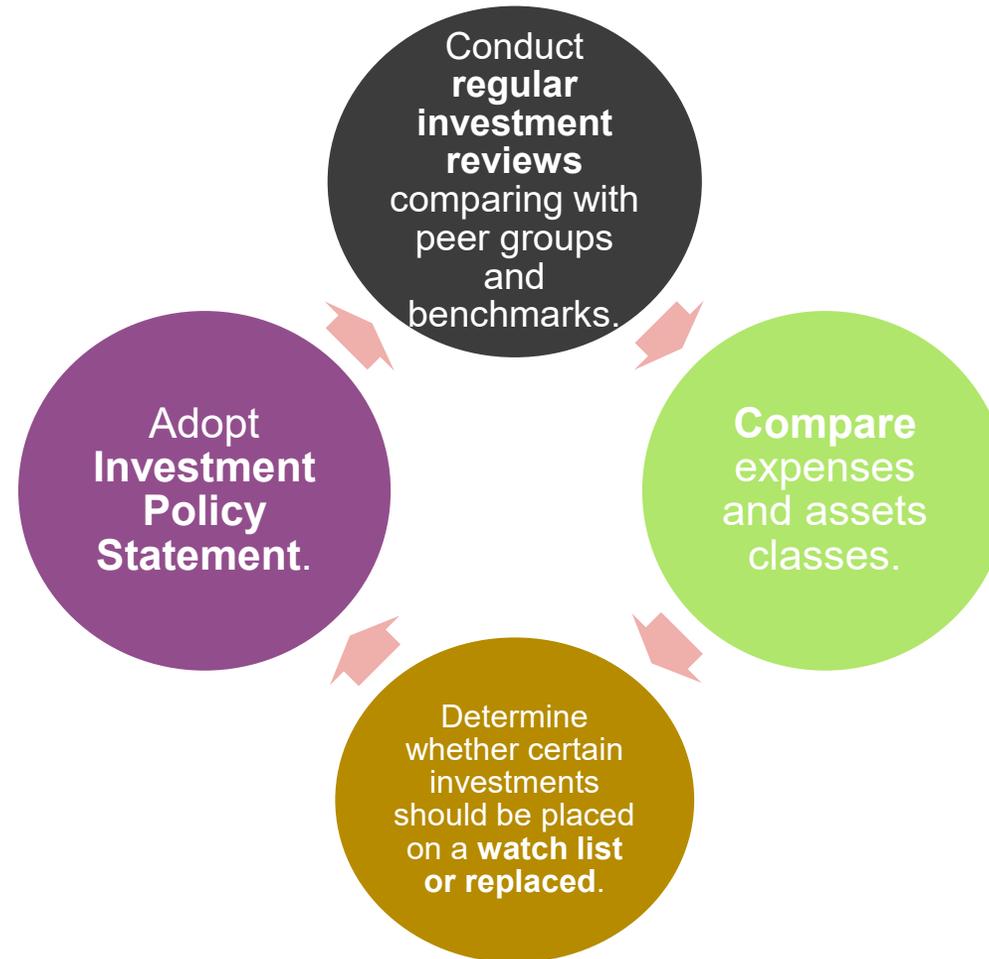
## Examples of Delegation:

- A fiduciary might delegate authority to invest plan assets to an investment committee.
- A fiduciary might delegate authority to make final decisions in medical claim decisions to a third-party administrator.

# Duty of Prudence – Diversification

- Duty to diversify the investments of the plan to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so.
- Fundamental to the prudent management of risk.

# Duty of Prudence = Duty to Monitor



# Duty to Follow Plan Documents

- Fiduciary duty to administer a plan in good faith in accordance with its **written terms – "by the book."**
- Burden on fiduciary to understand the:
  - Governing documents of the plans - plan document, investment policy statement, etc.
  - Statutory and regulatory parameters
  - Context in which the plans exist

# Negative Duties: Prohibited Transactions

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## **A fiduciary may not:**

Deal with plan assets in his or her own interest.

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Pay unreasonable compensation for services performed.

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Make a purchase for more than adequate consideration or a sale for less than adequate consideration.

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Act on behalf of a party whose interests are adverse to the plan or participants.

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Receive anything of value from any party in connection with a transaction involving plan assets.

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# Key Takeaways

Highest duty known to law.

Objective standard:

- Prudent "expert" standard.
- Good faith is not sufficient.
- If you don't know, learn or hire an expert.

If it is not documented, it cannot be substantiated.

# Fiduciary Liability

# Fiduciary Liability

Plan fiduciaries are **personally liable** for a breach of fiduciary duty based on their own conduct or failure to act.

- **Personally** liable to make good any losses suffered by the plan as a result of the breach
- **Personally** liable to restore to the plan any profits the fiduciary made through the use of plan assets
- Plan assets cannot be used to pay for the fiduciary's liability
- Also subject to equitable relief, such as removal as a fiduciary

# Co-Fiduciary Liability

- Plan fiduciaries also are **personally liable** for the breaches of their **co-fiduciaries**:
  - If they knowingly participate in or conceal the breach
  - If they enable their co-fiduciary to commit the breach
  - If they have knowledge of the breach and fail to make reasonable efforts to remedy the breach
- Plan fiduciaries have a duty to use reasonable care to monitor the actions of one another

# Indemnification and Defense under Cal. Gov't Code Sections §§ 995 – 996.6

Public entity employees are entitled to defense and indemnification by a public entity employer under certain circumstances.

“Except as otherwise provided in Sections 995.2 and 995.4, upon request of an employee or former employee, a public entity shall provide for the defense of any civil action or proceeding brought against him, in his official or individual capacity or both, on account of an act or omission in the scope of his employment as an employee of the public entity.”  
Cal. Gov't Code § 995

# Examples of Fiduciary Acts Related to Health Plans

# Acceptance and Application of Employee Contributions and Other Plan Assets

- Employee contributions are plan assets.
  - U.S. Department of Labor has stated: "all amounts that a participant pays to or has withheld by an employer for purposes of obtaining benefits under a plan become plan assets without regard to when related plan expenses or benefits are paid by the employer."
- Plan fiduciaries have an obligation to use those contributions solely for purposes of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.
- A fiduciary must act prudently with respect to the investment, disbursement and use of the funds, including monitoring the investments in which the funds are placed. In many cases, prudence would require the engagement of an investment advisor or manager (the selection of which would also constitute a fiduciary function).

# Maintaining and Applying Claims and Appeals Procedures

- Charter Section 12.200 requires the Board to act upon member appeals. HSS rules detail that process.
- Group health plans must have reasonable claims procedures for participants to submit claims for benefits.
- Deciding these claims and appeals (*e.g.*, whether a medical service is covered under a plan, whether a service is medically necessary or experimental, and how much the plan will pay for the service) is a core fiduciary function.
- A named fiduciary might delegate some or all claims decisions to a third-party administrator; however, if the plan sponsor retains final decision-making authority over plan appeals, it remains the claims fiduciary under the plan.
- If a plan's administrator delegates the appeals authority to a third-party administrator (“TPA”), it must do so prudently and it must ensure that the TPA is properly conducting this function.

# Maintaining and Applying Claims and Appeals Procedures (cont'd)

- A fiduciary has a duty to adjudicate claims in compliance with applicable legal authority and in compliance with the terms of the plan.
  - A fiduciary may not adjudicate claims inconsistently based on individual circumstances.
  - Under the duty of loyalty, all plan participants must be treated equally.
  - Claims and appeals must follow applicable laws and IRS guidance.
- Claims determinations must be made in a manner that does not discriminate in terms of disability or other health status factors in violation of the ADA, GINA, or the nondiscrimination rules under HIPAA.
- A fiduciary must follow the plan's claims and appeals procedures and must not be arbitrary or capricious in its claims determinations.
- A fiduciary must adjudicate those claims applying the terms of the plan and not in a manner that would benefit the plan's sponsor in its role as the funding agent of the plan.
- Because the Plan is self-funded, the Plan is subject to the requirements under Code Section 105(h) that it not discriminate in favor of highly compensated individuals.
  - Favoring highly compensated individuals in eligibility and other aspects of the Plan can result in the benefits of the Plan becoming taxable income to highly compensated individuals.

# Communicating with Participants

- Communicating with participants can be a fiduciary function when the fiduciary is communicating about plan benefits.
- Misrepresentations made in participant communications can constitute fiduciary breaches.
- In an ERISA case decided by the U.S. Supreme Court, an employer – acting in its role as a plan administrator – made intentional misrepresentations to plan participants about the health plan's financial condition and future security.
  - The Court determined that this misrepresentation was an exercise of discretionary authority over the management and administration of the plan and was an act of plan administration.
  - The Court determined that to participate knowingly and significantly in deceiving a plan's beneficiaries in order to save the employer money at the beneficiaries' expense is not to act "solely in the interest of the participants and beneficiaries." As a result, the Court found the communication to be a violation of fiduciary duty.

# Communicating with Participants (cont'd)

- However, courts have declined to find fiduciary breaches where a plan sponsor merely provides incorrect information or information that the plan sponsor believed was true at the time it was communicated but was later found to be incorrect or misleading.
- A fiduciary duty to communicate with participants might arise where a plan sponsor is considering changes to a plan that might affect participants' rights and decisions related to the plan.
  - This duty does not arise until changes to a plan are under "serious consideration."
  - Under one court's test, once plan changes are under "serious consideration," plan fiduciaries should disclose the potential changes to participants, must not mislead participants about those future changes, and must disclose whether the benefit changes are being contemplated if a participant asks about them.
  - For these purposes, "serious consideration" exists when there is a specific proposal that is being discussed for purposes of implementation by senior management with the authority to implement the change.
- Board Communications Policy requires Board members to exercise judgment and discretion when communicating with members.
  - May communicate general information or simple factual information when no risk of communicating inaccurate information.
  - May not provide education, advice, or technical information.

# Selecting Service Providers and Negotiating Rates with Networks

- Hiring service providers and negotiating rates with network providers are also fiduciary functions.
- Key to the exercise of this fiduciary function is the need to observe the fiduciary's duty of loyalty. The duty of loyalty prohibits fiduciaries and other parties with a connection to a plan from engaging in self-dealing with respect to the plan.

# Selecting Service Providers and Negotiating Rates with Networks (cont'd)

- When selecting service providers, plan fiduciaries must engage in an objective process designed to elicit information necessary to make a prudent decision that is in the best interest of the plan and its participants and beneficiaries.
  - This process is critical to demonstrating that fiduciaries have observed their duties of prudence and loyalty.
  - The emphasis is on a complete and objective process more than on the best possible result.
  - Courts have held that the test of prudence is one of conduct, and not a test of the result of performance of the vendor.
    - Although, when a fiduciary has knowledge, or should have knowledge, of a vendor's poor performance, it must act or risk violating its fiduciary duties.

# Selecting Service Providers and Negotiating Rates with Networks (cont'd)

- A fiduciary must seek independent advice when the fiduciary lacks necessary expertise to evaluate a vendor, but the fiduciary must exercise independent judgment after reviewing and analyzing the expert's recommendation. Courts will look at whether a fiduciary has documentation and took the time for proper reflection and discussion.
- Board Term of Reference 26 recognizes the need for the Board to rely on the expertise of staff and others in the vendor selection process and limits the Board's role to the approval and award of final contracts for primary service providers.

# Selecting Service Providers and Negotiating Rates with Networks (cont'd)

- An objective process for selecting plan service providers will assess and document, among other things:
  - the services offered
  - the fees charged by the service provider
  - the financial health and experience of the service provider
  - the quality of services
  - the qualifications of the available medical providers and specialists
  - ease of access to providers
  - accreditations
- The process need not necessarily result in the selection of the lowest priced vendor.
  - The Department of Labor has stated that it would be a violation of fiduciary duty to not take quality into consideration – even if the vendor is more expensive. The Department of Labor has stressed that the selection and evaluation process must "be designed to avoid self-dealing, conflicts of interest or other improper influence."

# Ensuring Legal Compliance

- Health Plans are subject to an increasingly complex set of laws.
  - Affordable Care Act
  - Mental Health Parity and Addictions Equity Act
  - No Surprises Act
- Fiduciaries have a duty to ensure plans are in legal compliance.
  - HSS conducts regular audit activities to monitor compliance and reports to the Board
- Facets of these laws can also be used to evaluate health care spending and make plan adjustments, introduce managed care, negotiate rates, and reduce fees.

# Creating a Prudent Process

# The Focus is on Process

- Focus on **procedural prudence**.
- Courts have held the test of prudence is one of conduct and process, and not one of result.

# The Focus is on Process (cont'd)

There is no one "right" way to achieve procedural prudence.

Important to have a good, documented process.

Critical to follow that process.

Critical to retain expertise where needed and understand expert advice.

# Managing Fiduciary Risk

- Know and follow plan documents.
- Adopt written prudent processes and procedures and follow them:
  - Conflicts of Interest Policy
  - Charter for Committee
  - Investment Policy Statements
- Give appropriate consideration to facts and circumstances that fiduciary knows or should know are relevant.

# Managing Fiduciary Risk (cont'd)



# Managing Fiduciary Risk (cont'd)



# QUESTIONS AND DISCUSSION