

# Independent Fiduciary Services®

2008 National CLE Conference ® - LEI

***NOW THAT THE COURTS HAVE SPOKEN  
(AND WON'T SHUT UP):***

***Managing Fiduciary Risk In Company Stock and  
Other DC Plan Investment Options***

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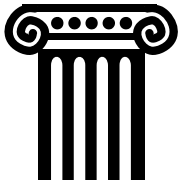
# Independent Fiduciary Services®

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## *Contents:*

- Emerging Trends for Company Stock
- Managing Company Stock
- Implications for Other Investment Options

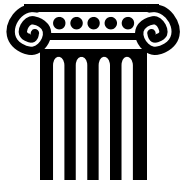


# Emerging Trends for Company Stock

## Eliminating Company Stock as an Investment Option

- ❖ Some anecdotal evidence but no widespread trend.
  - More pro-defendant court rulings in stock-drop cases
  - Company officials resist elimination strategy
- ❖ 2006 review by Congressional Research Service shows that 261 of 500 largest companies still offer Company Stock as an investment option.
- ❖ EBRI survey data show that participants are “voting with their feet”:
  - 44.5% of participants in plans offering Company Stock have none in their accounts at 12/31/06, up from 37% in 2004.
  - Company stock represents 11% of total 401(k) plan assets at 12/31/06, down from 19% in 1999.

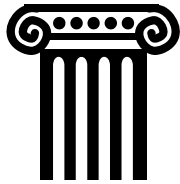
# Emerging Trends for Company Stock (cont'd)



## Limiting Company Stock as an Investment Option

- ❖ Bills were introduced post-Enron but none enacted.
- ❖ 2006 Survey data showed 17% of “large company” plans imposed limits, and 13% more were planning on introducing them.
- ❖ DOL model notice to participants cites 20% of investment in a single company.

# Emerging Trends for Company Stock (cont'd)

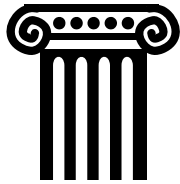


## Hiring Independent Fiduciaries

- ❖ As Advisor
- ❖ As Decision-maker

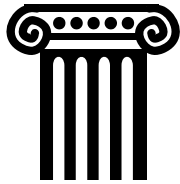
## Changing Composition of Plan Committee

# Emerging Trends for Company Stock (cont'd)



## “Baking In” Company Stock in the Plan Document/KSOP

- ❖ Intended to exclude the Company Stock Fund from the scope of fiduciary discretion.
- ❖ Sharply limits the fiduciary committee’s ability to respond to events impacting the Company Stock.
- ❖ DOL footnote in the 404(c) regulations may undermine the effectiveness of this strategy if no KSOP (but see *Langbecker v. EDS*)
- ❖ Will the “settlor” doctrine really stand up when the facts get ugly?



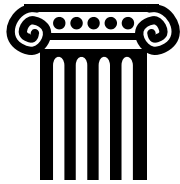
# Managing Company Stock

## Importance of Process

- ❖ Document who has authority for what

THE WHO	THE WHAT
The Board of Directors and its Committees	Eliminate the Stock Fund
The Fiduciary Committee(s)	Set/Change “Liquidity Level”
Company Executives	Suspend/Limit/Freeze
Contributions	
The Trustee	Communicate with Participants

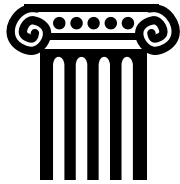
- ❖ Regular Reports to the Right People
- ❖ Document Deliberations and Decisions



## Managing Company Stock (cont'd)

### What to Watch (Can you really wait until the Company's "imminent collapse?")

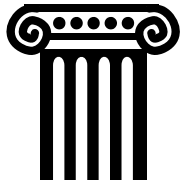
- ❖ If *Moench* applies, the key is recognizing when “investing in employer securities would defeat or substantially impair the accomplishment of the purposes of the trust.”
- ❖ The “brink of bankruptcy” is not required to trigger a duty to divest. *Edgar v. Avaya, Inc.*
- ❖ Watching the stock price is not enough, and by itself is just not relevant.
  - Claim dismissed in *Smith v. Delta Air Lines* despite 92% decline in stock price.
  - Claim dismissed in *In re McKesson HBOC, Inc. ERISA Litigation* despite 75% decline in stock price.
- ❖ Judge Posner in *Summers v. State Street Bank*: The Debt-Equity Ratio



# Managing Company Stock (cont'd)

## What to Watch (Can you really wait until the Company's “imminent collapse?”) (cont'd)

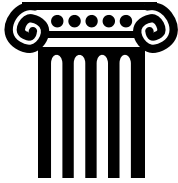
- ❖ Other fundamentals about the Company (*Landgraff v. Columbia/HCA*)
  - Government investigations
  - Earnings restatements
  - Wall Street analysts
  - Bond ratings
  - Revenues
  - Net Income
  - Cash Flow
  - Significant litigation/regulatory challenges at the heart of the business
  - Pension funding? (*In re General Motors ERISA Litigation*)



# Managing Company Stock (cont'd)

## What to Watch (Can you really wait until the Company's “imminent collapse?”) (cont'd)

- ❖ The Stock (in isolation and compared to peers)
  - P/E, P/B, EPS
  - Insider trades/short sales
  - Performance versus broad indices and peers
- ❖ The Plan
  - Plan demographics
  - Trends in concentration of Company Stock
  - The breadth of other investment options (but the Fourth Circuit opinion in *DiFelice v. US Airways* saw things a lot differently than did the District Court)



# Managing Company Stock (cont'd)

## What to Do with All this Information

- ❖ Consider communicating with participants
- ❖ Consider hiring an independent fiduciary
- ❖ Consider diversifying the Company Stock Fund itself
- ❖ Amend the Plan to impose limits or even eliminate the Company Stock Fund



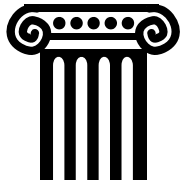
# Implications for Other Investment Options

## Selecting the options is still a fiduciary decision

- ❖ DOL footnote in the 404(c) regulations
- ❖ But *Langbecker v. EDS* decision may mitigate liability for imprudent selections

## What about diversification? 4<sup>th</sup> Circuit decision in *DiFelice* says (in dictum) every option must be prudent

- ❖ Does this mean you have to assume for each option that it would be prudent if a participant put all of her assets in it?
- ❖ How diverse must each option be?
  - What about the “Dogs of the Dow” Strategy?
  - See, e.g., the Van Kempen Nasdaq Select 10 Portfolio (10 stocks)



## Case Citations

- ❖ *DiFelice v. US Airways, Inc.* 497 F. 3d 410 (4th Cir. 2007).
- ❖ *Edgar v. Avaya, Inc.*, \_\_\_ F. 3d \_\_\_, 2007 WL 2781847, Case No. 06-2770 (3d Cir. Sept. 26, 2007).
- ❖ *In re General Motors ERISA Litigation*, 37 EB Cases 1951 (E.D. Mich. 2006).
- ❖ *Landgraff v. Columbia/HCA Healthcare Corp.*, 2000 WL 33726564 (M.D. Tenn. 2000), *aff'd*, 30 Fed. App. 366 (6th Cir. 2002) (Table).
- ❖ *Langbecker v. EDS*, 476 F. 3d 299 (5th Cir. 2007).
- ❖ *In re McKesson HBOC Inc. ERISA Litig.*, 29 EB Cases 1229 (N.D. Cal. 2002), 391 F. Supp. 2d 812 (N.D. Cal. 2005), *cert. denied*, 516 U.S. 1115 (1996).
- ❖ *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995).
- ❖ *Smith v. Delta Air Lines, Inc.*, 422 F. Supp. 2d 1310 (N.D. Ga. 2006).
- ❖ *Summers v. State Street Bank & Trust Co.*, 453 F. 3d 404 (7th Cir. 2006), *cert. denied*, 127 S.Ct. 1249 (2007), *cert. denied*, 127 S.Ct. 1257 (2007)