Are You A Fiduciary?

The Employee Retirement Income Security Act (ERISA) imposes four particular standards on 401(k) plan fiduciaries. These four standards are: 1) the duty of loyalty; 2) the duty of prudence; 3) the duty to diversify investments; and 4) the duty to follow plan documents. What many directors, officers, business owners and employees fail to understand are the many responsibilities and liabilities of functioning as a fiduciary under ERISA.

Who is a fiduciary?

A person can become a fiduciary in one of two ways. First, when they are expressly appointed a fiduciary, generally as the plan administrator, plan trustee, or member of an administrative or investment committee. Second, when they perform a duty or function that is deemed to be a fiduciary function. As a general rule this includes anyone who exercises discretionary authority over plan assets, renders investment advice for a fee, has some discretionary authority in the administration of the plan, or appoints or removes individuals and other parties who exercise any of the first three functions.

What are the duties of a fiduciary?

Historically, the three key principles that guide the actions of a fiduciary are:

- act solely in the best interest of plan participants and their beneficiaries
- act for the exclusive purpose of providing benefits to the participant
- use the care, skill, and prudence of a "Prudent Expert" in the management of 401(k) plan assets

Fiduciaries are also prohibited from dealing with plan assets in the fiduciary's own interest or for the fiduciary's own account; acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interest of the plan or its participants and beneficiaries; or receiving any consideration for the fiduciary's own personal account from any person dealing with the plan in connection with any transaction involving plan assets.

The concerns of fiduciaries have historically been focused on investment related decisions, but their duties and responsibilities go beyond the investment arena. In a recent article by the law firm of Reish Luftman & Reicher[1] discussing a lawsuit filed by the U. S. Department of Labor (DOL) against the Enron Corporation, they observe that this lawsuit "is a primer on the DOL's attitude about how plan fiduciaries -- whether or not they are named as fiduciaries -- need to go about their jobs." The article notes some of the more important points made by the DOL including:

- Plan fiduciaries have an obligation to pay attention to "warning signs," to consider their import, and to take action accordingly.
- Plan fiduciaries must meet regularly, and consider the prevailing circumstances that impact the plan.
- Company officers must provide fiduciaries with information that is relevant to the performance of the fiduciaries' duties.
- Plan fiduciaries must periodically review the suitability of the plan's investment options.
- Company officers who appoint plan fiduciaries have an ongoing duty to monitor their performance.
- Fiduciaries must speak and communicate truthfully and completely.

Also remember that a fiduciary's obligations to the plan participants outweigh those to their boss, the board of directors or to the shareholders.

Fiduciaries are personally liable.

ERISA §409 provides that any "person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be **personally liable**[2] to make good to such plan any losses to the plan resulting from each such breach...." The fiduciary may also be personally responsible for paying any civil penalties or excise taxes imposed on an employer by a Court of Law.

Fiduciaries can also be held liable for failing to take reasonable steps to correct another fiduciary's breach of duty.

In today's litigious society, people who perceive they have been wronged react with lawsuits that can cost millions of dollars to defend and settle. This makes fiduciaries potential lightning rods of liability, particularly in light of the amount of money held in retirement plans today. Bottom-line is that the financial risks of being a fiduciary are great and they should take their duties very seriously.

Misconceptions about fiduciary liability exposure.

Many plan sponsor fiduciaries harbor several misconceptions about their exposure to liability for fiduciary breaches. The most common are:

- We hired an outside investment manager to handle all our investment issues, so we have no liability anymore. FALSE. While doing so can reduce the liability, you still carry great exposure for having hired the investment manager.
- We allow our employees to make all their own investment decisions, so we have eliminated our liability. FALSE. Plan fiduciaries are still responsible for determining which investment options are made available in the plan and have a duty to monitor those options closely. Further, it you are not fully 404(c) compliant, you are responsible for the very investment choices your employees are making.
- My ERISA Fidelity bond protects the fiduciaries from this exposure. FALSE. An ERISA Fidelity Bond only protects the plan from a loss due to dishonest acts of trustees. You need a separate fiduciary Liability Policy to protect the personal assets of a plan fiduciary for Wrongful Acts.
- My Directors & Officers Liability policy protects the fiduciaries from this exposure. FALSE. D & O insurance does not protect against fiduciary responsibilities nor does your General Liability insurance.

Procedural Prudence

So how do you protect fiduciaries and ensure that you are acting solely in the best interest of plan participants and their beneficiaries? It is called "Procedural Prudence." Let me explain briefly.

Fiduciaries are not required to make perfect investment decisions, but they must establish and follow good processes and document their actions at every turn to show due consideration. This is often called "Procedural Prudence" and the principle should be applied to all decisions and actions taken by a fiduciary. They should position themselves to be able to defend their conduct and decisions by building a record that will demonstrate "Procedural Prudence" that can withstand close scrutiny. To do so, they must assume that their decisions will be examined in detail in the future. Documentation is critical and spans a wide array of both internal and external reporting requirements. This documentation should be built into an audit file that can be quickly produced and reviewed to demonstrate "Procedural Prudence."

1. Fred Reish, Bruce Ashton and Joe Faucher, "Department of Labor Sues Enron," ASPA ASAP No. 03-17 (July 21, 2003), Copyright 2003 ASPA.

2. Generally, corporate liabilities do not attach to the personal assets of individuals. However, the corporation can not shield the individual from liability in certain circumstances. One of these circumstances is when that individual is acting as a fiduciary, whether he realizes it himself or not.

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