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FIDUCIARY ROLES AND RESPONSIBILITIES UNDER ERISA DEFINED CONTRIBUTION RETIREMENT PLANS

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Fiduciaries of defined contribution retirement plans are under closer scrutiny than ever before. Plan participants are filing lawsuits, the media have increased attention on fiduciary failures, and during plan audits the U.S. Department of Labor (DOL) now routinely asks for evidence of fiduciary training. In light of the potential personal liability, it is imperative that plan fiduciaries understand their responsibilities and adhere to the standards of conduct that apply to them.

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Identifying Plan Fiduciaries

Before discussing a retirement plan fiduciary's roles and responsibilities, one must first determine who the fiduciaries are, and, perhaps just as important, who is not a fiduciary. All ERISA plans must have at least one fiduciary (which can be a person or an entity, e.g., the Investment Committee) that is named in the plan document. Often, there are other fiduciaries—not because of their title or position, but rather because of their actions. Anyone who exercises discretion in administering or managing the plan or controlling the plan's assets is a fiduciary to the plan.

Decisions are made and actions are taken routinely as part of administering a retirement plan. Some are business decisions and not fiduciary actions. Actions made on behalf of the plan are fiduciary actions, whereas actions made on behalf of the business are not. For example, the decision to establish a retirement plan is a business decision. However, when the employer (or someone acting on the employer's behalf) takes steps to implement the plan, that becomes a fiduciary action.

The following are examples of fiduciary functions vs. non-fiduciary actions:

Fiduciary Actions:

- Hiring/firing a service provider
- Appointing other fiduciaries
- Selecting investment options for the plan
- Interpreting plan provisions

Non-Fiduciary Actions:

- Plan design
- Decision to establish or terminate a plan
- Discretionary amendments
- Determining contribution amount

A plan's fiduciaries will generally include the trustee, investment advisor, all individuals exercising discretion in the administration of the plan, all members of the Investment Committee (if there is one), and those who selected the members of the Investment Committee. Other individuals who may be involved in some manner with the plan, including attorneys and accountants, are generally not fiduciaries when providing professional services to the plan.

The standards imposed on fiduciaries are significant and failure to abide by those standards can result in personal liability to the fiduciary, including monetary penalties and incarceration. Therefore, identifying all of the plan fiduciaries and having them acknowledge their fiduciary status is considered a best practice.

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Duties of a Fiduciary

Fiduciaries are bound by standards of conduct as set forth in ERISA:

- **Act solely in the interest of plan participants and beneficiaries.**
  Fiduciaries must always act solely for the benefit of plan participants and beneficiaries. They cannot let their position in the organization influence their decision-making as a fiduciary. In those instances where a fiduciary is also a participant in the plan, it is important that the fiduciary put personal interests aside and act only for the benefit of all plan participants.

- **Offer a diversified set of investments.**
  Investment options must be diversified to minimize the risk of large losses. This is generally not a problem for most defined contribution plans such as 401(k) and 403(b) plans, as these generally offer a broad range of investment options.

- **Abide by the law and the plan documents.**
  The plan document is the operating manual for the retirement plan. Fiduciaries must abide by the provisions of not only the actual plan document but all related documents, including the investment policy statement, the trust agreement, and other documents that discuss how the plan should be operated. The first step in meeting this standard is to actually read the documents. In those situations where there is a difference between the plan document and the law, the law would supersede the plan document.

- **Use plan assets exclusively for the plan.**
  Plan assets can only be used for two purposes: to pay plan benefits and to pay reasonable and necessary expenses of administering the plan. Determining what is reasonable and necessary will be discussed further in this paper.

- **Act prudently.**
  The duty to act prudently is central to a fiduciary's responsibilities and applies to every decision a fiduciary makes. ERISA §404(a)(1)(B) sets forth the "prudent man" rule:

  Fiduciaries must act

  "...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 a like character and with like aims."

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The important point to be taken from this rule is that fiduciaries are not judged on whether they made the correct decision; rather, they are judged on whether the decision was prudently made. That is, was the process used to make the decision thorough, consistent, and well-documented? One of the most common instances where this is evident is in the selection and monitoring of investments within a retirement plan.

- **Thorough:** This provision is not limited to what the fiduciary knows but extends to what he or she should know. The fiduciary must have or obtain the same information that someone knowledgeable in the field would use to make the decision. Lacking the ability to obtain the information or interpret and analyze the data, the fiduciary must seek the advice of an expert.

- **Consistent:** Fiduciaries are judged on process rather than end results. Therefore, it is important to have written procedures for common plan decisions and to follow those procedures each time the decision is made. The procedures should be updated and modified as necessary to accurately reflect changing conditions.

- **Well-documented:** Simply put, if the process is not documented, it did not happen. It is important for fiduciaries to be able to demonstrate the steps they took and the decisions that were reached to fulfill their responsibilities.

Fiduciary Liability

Perhaps one of the most important reasons to ensure all fiduciaries are aware of their responsibilities is the personal liability they have for a fiduciary breach. Fiduciaries who do not follow the standards of conduct may be personally liable to restore any losses to the plan, including lost profits. Some violations—for example, theft of plan assets—may also result in criminal penalties, including fines and jail sentences. It is important to note that fiduciaries may also have potential liability for the actions or inactions of the other plan fiduciaries. For example, a fiduciary that participates in or is aware of the breach of another fiduciary is also liable. Under the law, the fiduciary may be sued by the plan, the participants, or the Secretary of Labor.

Fiduciaries can limit their liability in some circumstances. Proper documentation of the process that was used to arrive at their decisions will serve them well in demonstrating their adherence to the standards of conduct.

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Prohibited Transactions

ERISA §406(a) prohibits various types of transactions between a plan and parties in interest. Parties in interest include all entities and individuals that provide services to the plan and would include the following:

- any fiduciary;
- a person providing services to the plan, including the plan auditor or service provider;
- an employer whose employees are covered by such plan; and
- a relative of any of the above.

ERISA states that a plan fiduciary shall not cause the plan to engage in a transaction if the plan fiduciary knows or should know that such transaction involves a direct or indirect:

- sale, exchange, or leasing of any property;
- lending of money;
- furnishing of goods, services, or facilities;
- transfer or use by or for the benefit of a party in interest, of any plan assets; or
- acquisition, on behalf of the plan, of any employer security or real property.

A plan fiduciary is also prohibited from receiving money or other consideration for their personal account from any party doing business with the plan related to that business.

One of the most common prohibited transactions involving the plan fiduciary is the failure to remit participant deferral contributions and loan repayments to the plan in a timely manner in accordance with DOL regulations.

Another potential prohibited transaction that has received increased scrutiny in recent months is advisor-guided IRA rollovers from qualified plans. IRA rollovers can result in an inherent conflict of interest for advisors servicing defined contribution retirement plans where such rollover may result in commissions or other fees being paid to the advisor. A fiduciary cannot take any actions to increase their compensation. DOL has suggested that if an advisor is a fiduciary to a plan, any rollover the advisor initiates and/or oversees may trigger a prohibited transaction, subject to all applicable excise taxes.

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These transactions will continue to be an area of focus as the Financial Industry Regulatory Authority (FINRA), the group charged with writing and enforcing rules governing the activities of securities firms and brokers, has made IRA rollovers an examination priority for 2014. In the meantime, all retirement plan fiduciaries should be aware of the types of transactions being initiated by advisors servicing the plan.

Certain transactions with parties in interest are exempt from the prohibited transaction rules, either because they are permitted by a statutory exemption in ERISA, covered under a class exemption issued by DOL, or DOL has issued an individual exemption.

Statutory exemptions, whereby plans may engage in certain transactions with parties in interest that would otherwise be prohibited by law, include the following:

- loans to participants or beneficiaries;
- the provision of services necessary for the operation of the plan for no more than reasonable compensation;
- distribution of the plan assets in accordance with the terms of the plan; and
- provision of any ancillary service by a bank or similar financial institution.

Class exemptions are blanket exemptions that permit a person to engage in a similar transaction with a plan without requiring the person to obtain an individual exemption. Class exemptions typically relate to transactions common in employee benefit plans that were not in practice when the statutory exemptions were enacted. An example of a class exemption is the purchase and sale of open-end mutual fund shares by a plan when a plan fiduciary is also the investment advisor for the investment company marketing the mutual fund.

Individual exemptions are administrative exemptions that apply only to the specific person named in the exemption; other plans may not rely on those exemptions even if all of the conditions are met.

ERISA and DOL regulations require that transactions with parties in interest (excluding any transactions exempted from prohibited transaction rules) be reported on the schedules to Form 5500. DOL may assess a daily penalty against a plan administrator who fails or refuses to comply with the annual reporting requirements.

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In the event a plan engages in a prohibited transaction, DOL has established the Voluntary Fiduciary Correction Program to aid plan administrators in self-correcting violations of ERISA, including prohibited transactions. The program includes specific transactions and their acceptable means of correction, eligibility requirements, and application procedures. More information is available on the DOL Web site at www.dol.gov/ebsa.

§404(c) Plans

In most defined contribution plans, the participants direct their own investments. However, unless the plan is a designated §404(c) plan, the plan fiduciary may still be liable for losses incurred by the participants.

To qualify as a §404(c) plan, the regulations require the plan to:

- offer a broad range of diversified investments, defined to be at least three investment options with materially different risk and reward characteristics, allowing participants to diversify their investments and select their desired risk level;
- give participants the ability to exercise independent control over assets in their accounts and to make investment changes at least quarterly; and
- provide participants with adequate investment information—specifically, a fair and balanced presentation of the investment options, easily accessible to all employees, and accurate and timely.

The §404(c) plan fiduciary is still responsible for selecting and monitoring the investment options, but would not be liable for investment losses.

It is important to note that, under the regulations, §404(c) status must be affirmatively stated. To ensure compliance, the plan document, certain participant communications, and Form 5500 should all clearly state that the plan is a §404(c) plan.

Hiring and Monitoring Service Providers

Hiring a service provider is a fiduciary function and the fiduciary can pay no more than reasonable fees for necessary services. There are a number of services that are necessary to administer a plan—recordkeeping, asset management, trustee services, brokerage services, participant communication, etc. Similarly, there are various ways in which these services can be paid for and delivered. Services can be bundled, where most or all of the needed services are provided by one company, or services can be

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provided by different providers. Fiduciaries must understand how the services are being delivered and assess the reasonableness of the fees being charged.

As with all fiduciary responsibilities, it is essential to have a well-documented process in place to select and monitor service providers. When considering prospective service providers, it is important to gather information about the services they will provide and a detailed explanation of the fees to be charged and how those fees will be paid. Additionally, DOL recommends plan sponsors obtain:

- information about the firm itself, including financial condition and experience with retirement plans of similar size and complexity;
- information about the quality of the firm's services, including the identity, experience, and qualifications of the professionals who will be handling the plan's account;
- any recent litigation or enforcement action that has been taken against the firm;
- the amount of fiduciary liability insurance carried by the firm; and
- the proposed fee structure.

As noted, fees are just one component that fiduciaries must consider when selecting service providers. Fiduciaries are required to ensure that the fees paid are reasonable in light of the services provided and the needs of the plan. It should be noted that "reasonable" is not another word for "cheapest." The service provider fee disclosures required by DOL §408(b)(2) regulations are a useful tool in understanding and comparing fees among the different providers.

Once the service providers are selected, it is important to regularly monitor their activities and fees. Fiduciaries should review service provider arrangements and fees annually, with a more thorough review every three to five years, including a benchmarking review or, if appropriate, a complete request for proposal undertaking. The review process and related findings should be documented.

Investment Selection

One of the major decisions a plan fiduciary makes is the selection of the investment options that will be available to plan participants. This can be particularly daunting to individuals who lack the expertise to make these decisions. In those instances, the fiduciary has an obligation to seek the advice of an expert. There are several options available to fiduciaries seeking expert advice:

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- **Retain a non-fiduciary advisor.** These advisors can provide diagnostic tools and other information about the investment options that can assist the fiduciary in making its decision. Because these advisors are not fiduciaries, the plan fiduciary is solely responsible for the investment decisions.

- **Retain a §3(21) fiduciary advisor.** The §3(21) advisor will provide information and make investment recommendations to assist the plan fiduciary in making the investment decisions. As a fiduciary, the advisor is liable for the content of its recommendations but does not have the authority to make the investment decisions. The ultimate authority for selecting the investment options rests with the plan fiduciary.

- **Retain a §3(38) fiduciary advisor.** In this instance, the plan fiduciary delegates complete authority to manage some or all of the investment decisions to the fiduciary advisor. The plan fiduciary is then responsible for selecting and monitoring the fiduciary advisor.

As with the service provider selection, it is important for the plan fiduciary to have a process in place for the ongoing monitoring of the investment options, including performance, fees, etc. To assist with this process, the plan fiduciary should consider developing an investment policy statement (IPS).

Although not required by ERISA, the IPS serves as a policy guide that can offer an objective course of action to be followed when emotional or instinctive responses might otherwise motivate less prudent action. The IPS is a highly customized document that is uniquely tailored to the preferences, design, and situation of each plan and sets forth the parameters which will be used for investment selection and monitoring.

Participant Advice vs. Education

Plan fiduciaries have a legal responsibility to provide certain plan information to employees, including Summary Plan Descriptions, fee disclosures, etc. ERISA §404(c) requires the plan to provide participants with adequate investment information; specifically, a fair and balanced presentation of the investment options available under the plan. However, it is important to distinguish between investment education and investment advice.

Most plan sponsors offer some form of participant investment education, often as part of the services provided from the investment provider. Investment education is general in nature, such as the details of the plan provisions, general investment strategies, and the importance of saving. Providing participant investment education is not a fiduciary function.

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Investment advice is individualized recommendations to the participant based on the specific investment options available in the plan. Many service providers cannot provide fiduciary participant advice because they have a financial interest in one or more of the investment options in the plan and doing so would result in a prohibited transaction. Plan sponsors can hire an independent advisor to provide investment advice. The advisor would be a fiduciary to the plan and the plan fiduciary would be responsible for the selection and monitoring of the advisor.

Conclusion

Legally, the ERISA fiduciary standard is one of the highest the law recognizes. Plan fiduciaries assume personal liability for their decisionmaking; thus, it is imperative that they understand their responsibilities and continually follow the standards of conduct that apply to them.

As defined contribution plans continue to grow in popularity, more attention will be paid to how these plans are administered, not only by regulatory authorities, but by plan participants, attorneys, and the media. At the same time, regulations governing these plans are constantly changing and plans are becoming more complex. It is imperative that plan fiduciaries be aware of and knowledgeable about their responsibilities, not only for the benefit of the plan and participants, but also for themselves.

About The Author

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Carol has nearly 20 years of experience in the financial services and retirement planning market, having previously worked at The Hartford and AIG Valic. Carol holds her FINRA series 7, 24, and 63 licenses, and is an Accredited Investment Fiduciary and a Certified Financial Planner.

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