

Are You A Plan Fiduciary?

From the book *Why 401(k) Plans Fail*
by Allen Vaughan

AllenVaughan+Co.

Independent Retirement Plan Consulting

5017 Trailridge Way • Suite 700 • Atlanta, GA 30338
phone 404.441.0064 • toll-free 800.686.401(k) • www.avco.us

Are you a fiduciary at your business or professional practice? The answer “I’m not sure” isn’t good enough, because if you are, you could be held personally liable for any wrongful act, knowing or unknowing, direct or indirect, including individual employee decisions associated with the administration of your benefit plans. Since the Employee Retirement Income Security Act (ERISA) was enacted in 1974, fiduciaries of employee benefit plans assumed new responsibilities relating to the management and administration of those plans. ERISA makes fiduciaries personally liable for any breach of responsibilities or duties imposed under the law.

These responsibilities should be taken seriously. Courts have found fiduciaries personally liable, even for acts of which they were unaware or in areas not considered within their scope of responsibility. Not knowing your responsibilities is not a defense. Neither is acting with good intentions or in good faith.

Are You an ERISA Fiduciary?

How can you determine if you are an ERISA fiduciary? As a general rule, you are a fiduciary of an employee benefit plan if you meet any one of the following tests:

- You exercise discretionary authority or control over plan assets or plan management.
- You are specifically identified in the written documents of a plan as a named fiduciary.
- You have discretionary responsibility in the administration of the plan.
- You manage the plan or its assets or render investment advice for a fee.

The good news is that your liability can be diminished by acting in a procedurally prudent manner. Therefore, you must follow the key fiduciary standards established under ERISA. You must be careful that all activities performed and all decisions made in the operation of your benefit plans are for the exclusive purpose of providing benefits to plan participants. ERISA requires fiduciaries to make decisions based solely on the best interest of plan participants.

You must exercise the same care, skill, and diligence that a “prudent person” familiar with the administration of employee benefit plans would exercise in managing similar matters. Acting in “good faith” is not enough. If a fiduciary lacks the expertise to meet the “prudent person” rule, ERISA requires a fiduciary to hire experts to help. When selecting plan consultants, trustees, or advisors, you must avoid selecting friends, acquaintances, or colleagues solely on the basis of their relationship with you. ERISA identifies criteria for selecting outside advisors, including the reasonableness of fees, qualifications and experience, license registration, business reputation, and client references.

Under ERISA, fiduciaries of retirement plans are required to diversify investments to minimize the risk of large losses. Plan fiduciaries may be relieved of the duty to diversify if the plan complies with the requirements of ERISA Section 404(c). ERISA also imposes disclosure requirements to provide various documents to participants, including summary plan description and summaries of material modification, summary annual reports, account statements, and fund descriptions. Finally, a fiduciary must act in a manner that is consistent with the legal documents of the plan.

A Broader Role

Even though ERISA was passed more than 30 years ago, the role of the fiduciary continues to be expanded as various court challenges are brought by employees and their beneficiaries. Fiduciaries have been found personally liable for the investment options in a retirement plan, as well as individual participant investment decisions. Fortunately, ERISA Section 404(c) allows fiduciaries to transfer legal responsibility for losses of an employee's investment choices to the employee if the retirement plan meets certain standards.

To comply with ERISA 404(c), your retirement plan must offer a broad, diversified investment menu having at least three "core" alternatives, each of which must be diversified. Each core alternative must have a different risk-and-return model. The employees must be able to create a portfolio suitable to their needs within a normal range, and the core alternatives must allow for thorough diversification when combined with other alternatives.

Offering a diversified portfolio is just the first step. You must permit individual investment decisions and provide written confirmation when decisions are exercised. Employees must be able to change their investment allocations at least quarterly and more often if appropriate in light of market volatility on specific investment alternatives.

If employees are to make their own investment decisions, they must be given sufficient information to do so, including information about the plan's terms and operating procedures, funds offered, the investments in which each fund placed its assets, the financial condition and performance of the investments both current and historically, and other information that affects the financial status of investments such as management tenure, trading fees, and investment restrictions.

The key to protection under 404(c) is to provide sufficient information to employees to enable them to exercise control over their investments. A strong education program about your retirement plan will help your plan meet the requirements of 404(c) and reduce fiduciary exposure.

Strengthening Protection

A recent Labor Department bulletin outlined the additional steps appropriate to help employees become more informed about investing their money for retirement. Associations should provide information relating to the benefits of plan participation, increasing individual contributions, and the value of investing over time. General investment concepts, such as tax deferrals, relationship between risk and return, value of diversification, and interest rate impact on investments, should be part of the overall education made available to employees. Interactive materials such as software and worksheets that help in estimating future retirement income needs, impact of asset allocation on different investments, and inflation should be incorporated in the fund offerings.

Other steps that can be taken to strengthen protection under 404(c) include increasing the "core" options from a minimum of three to five or six options to satisfy the broad range requirement. Also, asset allocation investment alternatives (lifestyle funds) are becoming much more popular in retirement plans.

What is a fiduciary to do with all of these duties and responsibilities? In addition to administering your benefit plans consistent with ERISA's requirements, you must have a fidelity bond to protect employees and their beneficiaries. ERISA requires this bond for all persons who handle plan assets. To fully protect the plan, the bond should be written for 10 percent of the assets up to a maximum of \$500,000.

In addition to the fidelity bond, you should consider fiduciary insurance coverage. Some association professional liability policies provide limited fiduciary defense. However, a separate fiduciary liability policy will help cover as many potential exposures as possible.

Fiduciary liability coverage is designed to meet the complex rules imposed by ERISA and related regulations. Coverage includes a broad definition of “wrongful acts” and provides defense protection and indemnification if a fiduciary is legally obligated to pay as a result of the wrongful act or breach of duties. Fiduciary liability coverage for civil penalties could be assessed under section 502(i) and 502(1) of ERISA.

Reducing Risk

Insurance by itself will not eliminate all risk to fiduciaries. Proper risk management demands that fiduciaries do the following:

- Take your fiduciary duties seriously. You are personally liable. Become educated as to duties, responsibilities, and liabilities.
- Hire third party experts — including ERISA attorneys and professional consultants when necessary.
- Attend seminars and other educational classes in order to keep current with ERISA's changing environment.
- Make sure employees receive accurate information on a timely basis.
- Monitor plan performance and meet the legal requirements of your plan.

In a litigious society such as ours, it doesn't pay to simply have the best interests of others in mind. Don't put your personal assets at risk. Determine if you are considered a fiduciary under ERISA and make sure you understand your duties. Understanding is the first step to protection. Then act on those duties as required by law.