

Fiduciary Responsibility in Retirement Plans: The Basics

Introduction

The Employee Retirement Income Security Act (“ERISA”) was passed in 1974 to regulate retirement and welfare benefit plans and protect plan participants and beneficiaries. Among its many other provisions, ERISA establishes a code of conduct for the fiduciaries of such plans, and imposes a regime of sanctions and penalties for failures to abide by its rules. Governmental and Church plans (with certain exceptions) are exempt from ERISA, but are subject to fiduciary rules established under state laws.

Who is a fiduciary under ERISA?

It is important to know who is a plan fiduciary, because fiduciaries have important responsibilities and are held to an extremely high standard of conduct under the law.

A fiduciary is a person that:

1. Exercises discretionary authority or control over the management of a plan, or the management or disposition of plan
2. Renders investment advice over the disposition of plan assets for a fee or other compensation
3. Has any discretionary authority or responsibility in the administration of a plan.

Whether a person is a fiduciary is a functional/fact intensive test, regardless of title. Activities that may cause a person to be considered a fiduciary include: selecting and monitoring plan investment vehicles; selecting and monitoring other fiduciaries and third party service providers; interpreting plan provisions; exercising discretion over claims, serving as a trustee and holding plan assets. Certain titles generally convey fiduciary status: e.g., trustee, plan administrator. A plan document must identify at least one (“named”) fiduciary. A person can be a fiduciary if he or she has power to act, even if that power is not exercised.

A plan sponsor is not acting as a fiduciary when it acts as a “settlor.” “Settlor” functions include installing, changing or terminating a plan, determining who should be covered under the plan, determining the amount of benefits that the plan will provide. Generally, professional service providers (attorneys, accountants, actuaries) will not be fiduciaries unless they exercise control over the plan or its assets.

It is important to review the plan document and the plan’s administrative procedures to ensure that individuals who are acting as fiduciaries, and those who have been given discretionary authority under the plan, understand their roles and responsibilities.

Fiduciary Duties

Fiduciaries have important responsibilities and their actions are subject to a very high standard under the law. Under ERISA, A fiduciary must perform his or her duties:

- A. Solely in the interest of the plan's participants and beneficiaries
- B. For the exclusive purpose of providing benefits to participants and beneficiaries and defraying the reasonable expenses of administering the plan
- C. By diversifying plan investments so as to minimize the risk of large losses unless it is clearly prudent not to do so
- D. In accordance with the documents and other instruments governing the plan, so long as those documents are consistent with ERISA.

Standard of Care

Prudent Person Standard: A fiduciary must act with the care, skill, prudence and diligence under the circumstances that a prudent person acting in a like capacity and familiar with such matters would use in the conduct on an enterprise of a like character and with like aims.

Whether a fiduciary is considered to have acted prudently is determined by evaluating his or her actions at the time a decision was made and by looking at the procedure by which a decision was made. Courts have focused on whether the fiduciary's decision making process was appropriate, rather than whether the decision was ultimately successful. Elements of a prudent decision making process include: 1) identifying relevant information; 2) using experts where necessary; and 3) documenting decisions.

Delegation of Fiduciary Responsibility

If permitted under the plan, fiduciary duties may be delegated to persons not named as fiduciaries if the delegation is done in accordance with plan provisions and in a prudent manner. If there is a proper delegation of authority, a fiduciary can be relieved of responsibility for the acts that are delegated as long as the fiduciary to which the responsibility was delegated was prudently selected and regularly monitored. A fiduciary is only liable for the duties it takes on pursuant to a valid division of responsibility under the plan.

Co- Fiduciary Responsibility

A fiduciary is responsible for the breach of a co-fiduciary when:

- A. A fiduciary knowingly participates in or conceals the breach,
- B. A fiduciary enables the co-fiduciary to commit the breach,
- C. A fiduciary has knowledge of the breach and does not make reasonable efforts to remedy it.

Selection of Service Providers and the Duty to Monitor

One of the most important functions that a fiduciary performs in the operation of a retirement plan is the selection of service providers, e.g., investment providers and recordkeepers. A fiduciary must establish a process for the prudent choice of service providers, as well as a process to monitor the performance of selected service providers on a regular and on-going basis. Specific procedures include:

- A. Regularly review the performance of service providers
- B. Review and understand the fees charged by the service providers to the plan
- C. Read the reports issued by the service providers
- D. Ask service providers about policies and practices
- E. Follow up on complaints from plan participants

Liability

A fiduciary can be held personally liable for any losses to the plan resulting from a breach of fiduciary responsibility. A civil action can be brought against a fiduciary by the DOL, a participant, a beneficiary, or another fiduciary. Any profits obtained by the fiduciary as a consequence of the breach must be restored to the plan, or the fiduciary must restore to the plan the amount of any loss. The DOL can assess a penalty on the amount payable by a fiduciary for a breach, and there are additional penalties and excise taxes for prohibited transactions. Criminal penalties exist for certain willful violations.

Limitation of Liability under ERISA section 404(c)

If a defined benefit, individual account plan (such as a 401(k) or 403(b) plan) meets certain detailed criteria, fiduciaries may be shielded from liability resulting from the investment decisions made by participants with respect to their own accounts.

- A. Participants must be able to choose from a broad range of investment alternatives and diversify investments within and among these alternatives. At least three investment alternatives at least three of the investment alternatives must be diversified, have materially different risk and return characteristics, and enable participants to achieve a portfolio with appropriate risk and return characteristics.
- B. Participants must be able to exercise control over the plan by giving investment instructions with a frequency that is appropriate in light of the market volatility associated with a particular investment option. The participants and beneficiaries must be provided with certain information and disclosures to make informed decisions, including: 1) that the plan is a 404(c) plan and what that means; 2) a description of the investment alternatives under the plan and a general description of risk and return characteristics; 3) an explanation of when and how to give investment instructions; 4) a description of fees and expenses under the investment options; and 5) if an investment alternative is a registered investment product, a copy of the most recent prospectus, delivered no later than immediately following the participant's initial investment.

- C. Additional information must be provided on request, including any prospectuses that are furnished to the plan.
- D. The fiduciary is not relieved of obligation to prudently select investment alternatives and monitor their performance.