The Basics of Fiduciary Responsibility under ERISA

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I Who Is A Fiduciary Under the Employee Retirement Income Security Act of 1974 (ERISA)?

Any person or entity who:

a. exercises discretionary control or authority over plan management or plan assets;

b. has discretionary authority or responsibility for the administration of a plan;

c. who provides investment advice to a plan for a fee or other compensation; or

d. has any authority or responsibility to do so, is a fiduciary with respect to the plan under the Employee Retirement Income Security Act of 1974 (ERISA).

A plan must have at least one fiduciary, who can be a person or an entity, named in the written plan document, or through a process described in the plan, as having control over the plan's operation. The named fiduciary can be identified by office or by name. For some plans, it may be an administrative committee or a company's board of directors.

A plan's fiduciaries will ordinarily include the trustee, investment advisers, all individuals exercising discretion in the administration of the plan, all members of a plan's administrative committee (if applicable), and those who select committee officials. Attorneys, accountants, and actuaries generally are not fiduciaries when acting solely in their professional capacities.

The key to determining whether an individual or an entity is a fiduciary is whether they are exercising discretion or control over the plan.

A. What decisions are fiduciary actions versus business decisions?

A number of decisions are not fiduciary actions but rather are business decisions made by the employer. For example, the decisions to establish a plan, to determine the benefit package, to include certain features in a plan, to amend a plan, and to terminate a plan are business decisions not governed by ERISA. When making these decisions, an employer is acting on behalf of its business, not the plan, and,

therefore, is not a fiduciary. However, when an employer, or someone hired by the employer, takes steps to implement these decisions, that person is acting on behalf of the plan and, in carrying out these actions, may be a fiduciary.

Many of the actions involved in operating a plan make the person or entity performing them a fiduciary. Using discretion in administering and managing a plan or controlling the plan's assets makes that person a fiduciary to the extent of that discretion or control. Thus, fiduciary status is based on the *functions performed for the plan*, not just a person's title.

II What is the Significance of Being a Fiduciary?[1]

Fiduciaries have important responsibilities and are subject to higher standards of conduct because they act on behalf of participants in a retirement plan and their beneficiaries. These responsibilities include:

a. Acting *solely* in the interest of plan participants and their beneficiaries and with the *exclusive purpose* of providing benefits to them;

b. Carrying out their duties *prudently*;

c. Following the plan documents (unless inconsistent with ERISA);

d. *Diversifying* plan investments; and

e. Paying only *reasonable plan expenses*.

The primary responsibility of fiduciaries is to run the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries must act prudently and must diversify the plan's investments in order to minimize the risk of large losses. In addition, they must follow the terms of plan documents to the extent that the plan terms are consistent with ERISA. Finally, they also must avoid conflicts of interest. In other words, they may not engage in transactions on behalf of the plan that benefit parties related to the plan, such as other fiduciaries, services providers or the plan sponsor.

A. The Duty of Prudence

The duty to act prudently is one of a fiduciary's central responsibilities under ERISA. It requires expertise in a variety of areas, including investments. Lacking that expertise, a fiduciary will need to hire someone with that professional knowledge to carry out the investment and other functions.

[1] A fiduciary should be aware of others who serve as fiduciaries to the same plan, because all fiduciaries have potential liability for the actions of their co-fiduciaries. For example, if a fiduciary knowingly participates in another fiduciary's breach of responsibility, conceals the breach, or does not act to correct it, that fiduciary is liable as well.

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Prudence focuses on the *process* for making fiduciary decisions. Therefore, it is wise to document decisions and the basis for those decisions. For instance, in hiring any plan service provider, a fiduciary may want to survey a number of potential providers, asking for the same information and providing the same requirements. By doing so, a fiduciary can document the process and make a meaningful comparison and selection.

B. *Operating the Plan in Accordance with the Plan Document*

Following the terms of the plan document is also an important responsibility. The document serves as the foundation for plan operations. Employers will want to be familiar with their plan document, especially when it is drawn up by a third-party service provider, and periodically review the document to make sure it remains current. For example, if a plan official named in the document changes, the plan document must be updated to reflect that change.

C. The Duty to Diversify

This key fiduciary duty helps to minimize the risk of large investment losses to the plan. Fiduciaries should consider each plan investment as part of the plan's entire portfolio. Once again, fiduciaries will want to document their evaluation and investment decisions.

D. *Paying Reasonable Plan Expenses*

As indicated, ERISA requires plan fiduciaries, when selecting and monitoring service providers and plan investments, to act prudently and solely in the interest of the plan's participants and beneficiaries. Responsible plan fiduciaries also must ensure that arrangements with their service providers are "reasonable" and that only "reasonable" compensation is paid for services. Fundamental to the ability of fiduciaries to discharge these obligations is obtaining information sufficient to enable them to make informed decisions about the services, the costs, and the service providers.

To ensure that plan fiduciaries are provided the information they need to assess both the reasonableness of the compensation to be paid for plan services and potential conflicts of interest that may affect the performance of those services, the Department of Labor published an interim final 408(b)(2) regulations on July 16, 2010, the "Plan Fee Disclosure Rules", that require retirement plan service providers to disclose comprehensive information about their fees and potential conflicts of interest to plan fiduciaries.[2] If the required disclosures are not made, the contract or arrangement will not be treated as "reasonable" and, will be treated as a prohibited transaction under ERISA.

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[2] The Plan Fee Disclosure Rules apply to plan contracts or arrangements for services in existence on or after January 1, 2012. Recently, the Department extended the deadline to April 1, 2012, in order to avoid compliance problems for both plans and the service providers.

Fees are just one of several factors fiduciaries need to consider in deciding on service providers and plan investments. When the fees for services are paid out of plan assets, fiduciaries will want to understand the fees and expenses charged and the services provided. After careful evaluation during the initial selection, the plan's fees and expenses should be monitored to determine whether they continue to be reasonable.

Some service providers may receive additional fees from investment vehicles, such as mutual funds, that may be offered under an employer's plan. For example, mutual funds often charge fees to pay brokers and other salespersons for promoting the fund and providing other services. There also may be sales and other related charges for investments offered by a service provider. A fiduciary should ask prospective providers for a detailed explanation of all fees associated with their investment options.

Who pays the fees? Plan expenses may be paid by the employer, the plan, or both. In addition, for expenses paid by the plan, they may be allocated to participants' accounts in a variety of ways. In any case, the plan document should specify how fees are paid.

III What Happens When There is a Breach of Fiduciary Duty?

Fiduciaries who do not follow these principles of conduct may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of plan assets. Courts may take whatever action is appropriate against fiduciaries who breach their duties under ERISA, including their removal.

IV How Can I Limit My Liability As A Fiduciary Under ERISA?

With these fiduciary responsibilities, there is also potential liability. As indicated, fiduciaries who do not follow the basic standards of conduct may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of the plan's assets resulting from their actions.

However, fiduciaries can limit their liability in certain situations. One way fiduciaries can demonstrate that they have carried out their responsibilities properly is by documenting the processes used to carry out their fiduciary responsibilities. There are other ways to reduce possible liability including indemnification agreements and delegating certain responsibilities to third-party administrators. [3]

A. ERISA §404(c) Protection

Some plans, such as most 401(k) and profit-sharing plans, can be set up to give participants control over the investments in their accounts and limit a fiduciary's liability for the investment decisions made by the participants. For participants to have

[3] Even if employers hire third-party service providers or use internal administrative committees to manage the plan, there are still certain functions that can make an employer a fiduciary.

control, they must be given the opportunity to choose from a broad range of investment alternatives.

Under the Department of Labor regulations, there must be at least three different investment options so that employees can diversify investments within an investment category, such as through a mutual fund, and diversify among the investment alternatives offered. In addition, participants must be given sufficient information to make informed decisions about the options offered under the plan. Participants also must be allowed to give investment instructions at least once a quarter, and perhaps more often if the investment option is volatile. While a fiduciary may have relief from liability for the specific investment allocations made by participants, the fiduciary retains the responsibility for selecting and monitoring the investment alternatives that are made available under the plan.

B. Automatic Enrollment Feature

Plans that automatically enroll employees can be set up to limit a fiduciary's liability for any plan losses that are a result of automatically investing participant contributions in certain default investments. There are four types of investment alternatives for default investments as described in Labor Department regulations and an initial notice and annual notice must be provided to participants. Also, participants must have the opportunity to direct their investments to a broad range of other options, and be provided materials on these options to help them do so. As indicated, while a fiduciary may have relief from liability for the automatic investments, the fiduciary retains the responsibility for selecting and monitoring the investment alternatives that are made available under the plan.

C. Service Providers

A fiduciary can also hire a service provider or providers to handle fiduciary functions, setting up the agreement so that the person or entity then assumes liability for those functions selected. If an employer appoints an investment manager that is a bank, insurance company, or registered investment adviser, the employer is responsible for the selection of the manager, but is not liable for the individual investment decisions of that manager. However, an employer is required to monitor the manager periodically to assure that it is handling the plan's investments prudently and in accordance with the appointment.

Remember that hiring a service provider in and of itself is a fiduciary function. When considering prospective service providers, a plan sponsor should provide each of them with complete and identical information about the plan and what services it is looking for so that the plan sponsor can make a meaningful comparison.

An employer should document its selection (and monitoring) process, and, when using an internal administrative committee, should educate committee members on their roles and responsibilities. In that regard, an employer should establish and follow a formal review process at reasonable intervals to decide if it wants to continue using the current service providers or look for replacements.

D. Bonding

As an additional protection for plans, those who handle plan funds or other plan property generally must be covered by a fidelity bond. A fidelity bond is a type of insurance that protects the plan against loss resulting from fraudulent or dishonest acts of those covered by the bond

When the sponsor of a plan that is subject to ERISA, for example, selects a third party to administer the plan, the selection of the third party administrator is, in and of itself, a fiduciary act. Accordingly, the plan sponsor needs to exercise due diligence in selecting a service provider and consider, among other things, the experience of the provider, the nature of the services to be performed and the fees to be charged. After the plan sponsor has selected a third party to administer the plan, the sponsor needs to monitor the activities of the third party administer.

V. Investment Advice and Education

More and more employers are offering participants help so they can make informed investment decisions. Employers may decide to hire an investment adviser offering specific investment advice to participants. These advisers are fiduciaries and have a responsibility to the plan participants.

On the other hand, an employer may hire a service provider to provide general financial and investment education, interactive investment materials, and information based on asset allocation models. As long as the material is general in nature, providers of investment education are not fiduciaries. However, the decision to select an investment adviser or a provider offering investment education is a fiduciary action and must be carried out in the same manner as hiring any plan service provider.

On October 21, 2010, the Department of Labor published a proposed rule that would amend the regulation interpreting the definition of "fiduciary" and significantly expand the types of investment advice activities that may give rise to fiduciary status under ERISA. According to the Department of Labor, the proposed rule takes into account current practices of investment advisers and the expectations of plan officials and participants who receive investment advice. The proposed rules, if finalized, will require a thorough review of the business practices of any person who deals with ERISA plans including brokers, valuation agents, custodians, lawyers, accountants, proxy advisory firms, and hedge funds and private equity funds that are not covered by ERISA but which provide fund values to ERISA plans.

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