

The Significance of Being an ERISA Fiduciary Minimize risk in today's market



William Gallagher Associates
Phone: 888.261.8884
www.WGAins.com

A fiduciary is **any** person who exercises **any** authority or control with respect to the management or disposition of employer plan assets. ERISA fiduciaries are either named in the plan document or are identified as such by the function they perform for the plan. Types of plans regulated by ERISA include: traditional pension plans, cash balance plans, 401(k) plans, profit sharing plans and employee welfare plans. Since fiduciary status may be based on a person's conduct rather than their title, it is possible to be a fiduciary without being aware of it!

Implications of being a Fiduciary

Fiduciaries have significant responsibilities and are subject to standards of conduct due to their role which is acting and

making decisions on behalf of participants, and their beneficiaries, in a retirement plan and other plans. Plans must be properly administered, invested and communicated. Under ERISA, fiduciaries are bound by certain duties and responsibilities which include:

- Responsible for the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them;
- Accountable to carry out their designated duties prudently ("prudent person rule");
- Eliminating conflicts of interest and self-serving acts (a.k.a. prohibited transactions);
- Enforcing and following the plan documents;
- Properly diversifying plan investments; and
- Diligently reviewing and paying only reasonable plan expenses.

The duty to act **prudently** is the most significant responsibility for a fiduciary under ERISA. The extensive requirements include expertise in a variety of areas, such as investments. Without that expertise, diligent fiduciaries will seek advice from a third party expert with experience and the professional knowledge to provide investment selection and monitoring, as well as other advisory functions. An example of exercising designated duties prudently would be to conduct the exact same analysis and process in the hiring or evaluation of any plan service provider. Fiduciaries should assess and analyze a number of potential providers, requesting the same data and information. If these parameters are followed, the fiduciaries can certify the decision making process and make a comprehensive comparison, a key risk management function.

Another important fiduciary responsibility is to closely follow the specifications of the plan documents. These documents provide the basis for plan operations. Fiduciaries have to educate themselves with the provisions of the plan, and frequently review the documents to ensure they are current and correct. For example, if a plan official named in the document or a plan is changed or is amended, then the plan document has to be updated and modified to represent that change or amendment.

Due to the recent volatility in the stock market, diversification of plan assets has become crucial. Fiduciaries need to exercise all possible actions to minimize the potential risk of large investment losses to the plans. Fiduciaries should consider each plan investment as part of the plan's entire portfolio. Again, fiduciaries need to analyze, evaluate and document their investment decision process.

William Gallagher Associates is a leading provider of insurance brokerage, risk management and employee benefits services to firms with complex risks, within industries that include high technology, life sciences, financial risks, healthcare services, energy, and environmental services. WGA has offices in Boston, MA; New York, NY; Hartford, CT; Princeton, NJ; Columbia, MD; Atlanta, GA; and Paris France.

Given the downturn in the economy, some increased litigation risks include:

- Stock Drops
- Revenue sharing /administration fees
- Securities Lending
- Investments with subprime exposure
- Fund Selections

Potential Liabilities of being a Fiduciary

Employee pension, benefit and compensation programs are increasingly becoming more complex and the uncertainty about these changing exposures and protecting against them continuously persist. Any individual serving as a trustee, or with any discretionary control over a pension plan or any other employee benefit plan has personal liability. Fiduciaries can be held personally liable for their actions and intentions. Fiduciaries who do not follow the basic standards of conduct can 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. Fiduciaries should make sure they have adequate insurance coverage, in the form of Fiduciary Liability and a Crime Coverage/Fidelity Bond.

Limiting Your Liability

In addition to companies securing comprehensive fiduciary liability insurance policies to protect the fiduciaries, there are other measures Fiduciaries can take to limit their liability in certain situations.

- One way fiduciaries can demonstrate that they have carried out their due diligence responsibilities properly is by documenting the processes used to carry out those responsibilities.
- There are other ways to limit potential liability. Some plans, such as most 401(k), profit-sharing, or 403(b) plans, can be set up to give participants control over the investments in their accounts. For participants to have control, they must be given the opportunity to choose from a broad range of investment alternatives. Under Labor Department regulations, there must be at least three different investment options so that participants can diversify investments within an investment category, such as a mutual fund, and diversify among the investment alternatives offered. In addition, participants must be given sufficient information to make informed decisions about the investment options offered in the plan. Participants also must be allowed to make investment changes (at least once a quarter) and more often if an investment option is relatively volatile.
- If an employer sets up their plan in this manner, a fiduciary's liability is limited for the investment decisions made by plan participants. However, a fiduciary retains the responsibility for selecting the providers of the investment options and the options themselves and monitoring their performance. The best way to monitor fund performance is to have a written Investment Policy Statement (IPS). Even though ERISA does not require an IPS, ERISA regulations state that having one is consistent with meeting plan fiduciary responsibilities. In a recent case, a federal district court found that the lack of an IPS was a breach of ERISA's "prudent man rule". An IPS can protect fiduciaries from litigation risk, by providing evidence that a prudent process was followed in selecting and monitoring investments offered in the retirement plan.
- A fiduciary can also hire a service provider 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 a bank, an insurance company, or registered investment advisor (RIA) as an

investment manager, 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 the prudent handling of the plan's investments. Retirement plans should go through an Annual Plan Review, which should include an objective analysis of the investments offered in the plan (historical rates of return, fund expenses, and volatility).

Other Plan Fiduciaries

Fiduciaries should also be cognizant of others who may serve as fiduciaries to the same plan, since all fiduciaries have liability for the actions of their co-fiduciaries. If a fiduciary knowingly participates in another fiduciary's breach of responsibility or professionalism, conceals a breach, or does not take remedies to correct a breach, that fiduciary is potentially liable as well.

There are approximately 9,000 ERISA cases filed each year. The ERISA plaintiffs bar continues to expand and become more aggressive and sophisticated every year. The most costly exposures come from cases alleging violation of ERISA Section 404 duties arising in plan-wide losses.

Most Common Types of Fiduciary Claims

The most frequently alleged claims against fiduciaries are:

- Denial or change of benefits
- Administrative error
- Incorrect benefit calculation
- Improper advice or counsel
- Misleading representation
- Wrongful termination of plan
- Civil rights denial or discrimination
- Failure to adequately fund a benefit program
- Conflict of interest
- Imprudent investment
- Cash balance plan conversions
- Employer stock investments

WGA can provide a comprehensive review of your fiduciary coverage, Investment Policy Statement, investment options, and retirement plan documents. For more information, contact your WGA Account Executive at William Gallagher Associates or email us at info@WGAins.com.

