



Defined Pension and Defined Contribution Plans

Who is a Fiduciary and What Does It Mean?

By:

Deborah A. Castellani, CFA and William C. Conrad

.....

Your company has a 401(k) or a Pension Plan and you are told you are the Plan's Fiduciary. What does it mean? What are your responsibilities? What is your liability? Lots of questions and most of the time, companies do not give you any information on your responsibilities and your liabilities. Sometimes they even forget to tell you that you are a Fiduciary.

For many of the individuals filling the role of a Fiduciary for a retirement plan is a task they have been assigned and not necessarily volunteered for. This may come with your Company Job Title like Human Resources Director, Controller and/or the management person with the most people under their direct supervision. True there are "named" fiduciaries, but even if no one told you that you are a Fiduciary for the "Plan", you may still be a Fiduciary under the Employee Retirement Income Security Act (ERISA).

Who is Not a Fiduciary?

To begin to understand what a Fiduciary is, we must first look at actions which are NOT considered Fiduciary actions.

These actions include:

1. Decision to establish a Plan
2. Decision to determine the benefit package
3. Decision to include certain features in a Plan
4. Decision to amend a Plan
5. Decision to terminate a Plan

Who is a Fiduciary and What Does It Mean? (cont'd)

Notice all of these decisions are made **PRIOR** to a Plan's creation. These are all business decisions made by the employer and thus not governed by the ERISA. When making these decisions, an employer is acting on behalf of its business and not the Plan or Plan Participants.

Once the decision is made to implement those decisions then people helping to implement the Plan are considered fiduciaries. Once the Plan is created every action that takes place after this creation must be made exclusively for the benefit of the Plan Participant. Every action and decision that happens from this point forward falls under ERISA.

The first step after the creation of the Plan document is choosing who internally will implement the Plan and hire the appropriate third parties (if necessary). This decision is the first fiduciary action.

Everyone involved in the Plan must fully understand who a fiduciary is, what are the duties, why this is important, and what happens if these duties are not fulfilled.

Who Is a Fiduciary?

The Department of Labor is not specific in who they define as a Fiduciary. They don't define a Fiduciary by title, but instead they feel that to determine if a person or entity is a fiduciary or not is to look at their duties. They state the key to making this determination is *"whether they are exercising discretion or control over the plan, acting solely in the interest of plan Participants and their beneficiaries, with the exclusive purpose of providing benefits to them."*

So as the Department of Labor states, fiduciary status is not based on title, but on the functions they perform.

A Plan's fiduciaries will ordinarily include the Board of Directors, trustee, investment advisers, all individuals exercising discretion in the administration of the Plan, all members of a Plan's administrative committee (if it has such a committee), and those who select committee officials.

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.

To help you understand, some of the duties include:

- Deciding if all or any functions for the Plan will be done in house or will utilize third party experts such as Investment Management, Trustees, and Record keepers.
- Making sure loan applications for the 401(k) are properly reviewed and processed.
- Checking or planning payout processing

Who is a Fiduciary and What Does It Mean? (cont'd)

- Processing trading instructions from a Plan Administrator
- Making sure 401(k) Participant contributions are invested in a timely manner

Then each member of the Board of Directors is a Fiduciary of the Plan and can mitigate their risk, but cannot eliminate their risk. They can delegate the day to day oversight to an individual or an Investment, Administrative or Oversight Committee, however, ultimate oversight still remains with the Board of Directors.

A Plan must have at least one Fiduciary (a person or entity) named in the written Plan, 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 it has such a committee), and those who select committee officials

What Are the Fiduciaries Duties?

Where the DOL is a little less specific in defining by title what a fiduciary is, the Employment Retirement Income Security Act (ERISA) is very specific about what duties a fiduciary has towards the Plan and the Plan Participants. There are 3 (Three) Major Duties:

1. Exclusive Benefit Rule – The fiduciary must discharge duties with respect to the Plan for the exclusive benefit of the Participant and their beneficiaries. You must think first and foremost for the Participant and what is best for them. Not the company, the officers, or even yourself, but the Participants as a whole.
2. Prudent Man Rule – A fiduciary must act “with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity” would act. This rule is derived from the common law of trusts. This is an objective standard based upon how a person with experience and knowledge of a certain area would act in a given situation. If a fiduciary lacks the expertise for a certain area then the fiduciary must obtain expert help.
3. Diversification Rule – A fiduciary must diversify investments in order to minimize risk of loss unless it would be considered prudent to not diversify investments. This means that you need to give you Plan Participants investment choices for a 401(k) and for a Pension it would mean to have a variety of assets in the Plan.

On its surface, two of the rules appear to be straight forward. You must think and act **exclusively** for the benefit of the Plan Participants. That makes sense, it is their Plan and it is

Who is a Fiduciary and What Does It Mean? (cont'd)

the Plan Participants' money. So intuitively that seems logical. Same holds true with the diversification. You should give them a variety of investment choices. The Prudent Man rule is not as straight forward.

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

Prudence focuses on the process for making fiduciary decisions. 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.

To illustrate, here is an example - A "Prudent Man" would not hire the first investment person he meets. He would research him/her. He would compare him/her to others. He would find the one that best suits his "criteria". The "Prudent Man" would then monitor him/her on a regular basis. He would have the investment manager educate him on how to best invest his money and on the choices that are available. A "Prudent Man" would document each part of this process. A "Prudent Man" would make sure the fees are reasonable as compared to others. He would make sure the returns are reasonable as well. A "Prudent Man" doesn't have to make sure it is the best, but he must make sure things are reasonable.

For an ERISA Plan, a "Prudent Man" would do all of that for each of the third parties he hires to help run the Plan. He would document each step of the process. He would also make sure that all those around him are educated including committee members on their roles and responsibilities. In a 401(k) Plan, that would include educating the Plan Participants on the basics of investing and the details of the investment choices they have.

Following the terms of the Plan document is also an important responsibility. The document serves as the foundation for Plan operations. Employers and Fiduciaries will want to be familiar with their Plan document, especially when it is drawn up by a third-party service provider, and you should periodically review the document to make sure it remains current as well as the third party service providers are following the Plan document.

Why is a Fiduciary Important?

Because Fiduciaries act on behalf of Participants in a retirement plan and their beneficiaries, Fiduciaries have extra responsibility and liabilities as outlined by the government. Fiduciaries are responsible for the monitoring, investment, and safekeeping of the retirement funds for each and every Plan Participant. The monies invested belong to the Participants and not to the company.

So What Happens If I Do Not Act Properly As A Fiduciary?

Failure to act as a Fiduciary will open the Plan, the Plan's fiduciaries and you personally to potential civil and even criminal liability. Plan Participants may bring civil action against fiduciaries in the event of a fiduciary breach, but only to "be made whole" for the Plan. They may only sue to recover personal damages.

It is logical to understand a Plan Sponsor (the company) may be held liable for failure to act properly, but a fiduciary may also be held **personally** liable for losses caused by his or her breach of ERISA. They may also be held liable for another fiduciary's conduct as well. Some examples of one fiduciary may be held accountable for another fiduciaries responsibility include:

- Failing to satisfy one's fiduciary duties, which leads to another fiduciary committing a breach
- Overlooking or concealing the acts of a co-fiduciary
- Having knowledge of a fiduciary breach and doing nothing to report or remedy the breach.

A fiduciary may not claim ignorance of fiduciary conduct within his or her oversight responsibility.

In recent years, lawsuits have become more prevalent against fiduciaries and Plan Sponsors. Depending on your Plan and the services that are provided, lawsuits can be filed by several different groups.

- Plan Participants (employees) and their beneficiaries, who are likely to sue for recovery of benefits or enforcement of their rights under ERISA
- The Department of Labor, to stop acts that violate ERISA and to collect civil penalties for prohibited transactions
- Third-party administrators
- The Pension Benefit Guaranty Corporation (this entity takes over for failed companies or pension plans)

An employer may also develop liabilities related to the Plan under the Internal Revenue Code. The requirements for a 401(k) Plan under the code range from technical testing mandates, such as not discriminating in favor of those employees considered to be "highly compensated," to failures to follow the terms of the Plan document. The latter failure is the easiest to remedy through periodic plan audits.

Who is a Fiduciary and What Does It Mean? (cont'd)

The most common fiduciary liability issues include:

- unacceptable choice of insurance company, mutual fund or third-party service provider
- failure to adequately fund a Plan
- failure to invest Participant contributions in a timely manner
- conflict of interest
- improper advice or counsel
- improper change in benefits
- improper amendments to the Plan document
- imprudent investment
- administrative error
- misleading representation
- lack of investment diversity
- incorrect benefit calculation

How Do I Protect Myself as a Fiduciary?

In the event of a breach, a fiduciary must act swiftly to report or correct the breach. The Plan must be returned to the state it was prior to the breach.

To safe guard yourself you need to consider and understand that YOU may also be taking on the risk of being personally liable in your role as a Fiduciary of a retirement plan.

1. Know who your Plan fiduciaries are and understand their roles.
2. Ensure that all of procedures and documentation have been put in place from the very beginning of the Plan.
3. Ask for qualified independent outside advice as soon as you think there is a problem or you are unsure about something.
4. Document, Oversee, Review, and Document
5. Understand all the costs of the retirement plan. Be skeptical, ask questions. Understand the true cost of recordkeeping and investment management.
6. Ask for a reconciliation of revenue sharing payments and any other Plan reimbursements.
7. Make sure the Plan is following any written documents. Are the Plan record keeper, trust company, and staff working on the Plan all following the Plan document and loan policy?
8. Look for conflicts of interest including prohibited transactions.

Who is a Fiduciary and What Does It Mean? (cont'd)

9. Does the Plan have an investment policy statement? Are investments being monitored and replaced if they are not meeting the policy requirements?
10. Rotate your committees or reassign responsibilities. This allows for a second set of eyes to uncover any mistakes or issues and allow for corrections.
11. Conduct regular annual compliance reviews or audits of the Plan policies, procedures, and operations.

Even if you think everything is okay ask for an independent Fiduciary to evaluate and assess what you are doing and how you are doing it. An Independent Fiduciary's "set of eyes" may not necessarily see things as you or your fellow Fiduciaries do.

Being a Fiduciary is critical because they are the eyes and ears of each Plan Participant. So a Fiduciary must learn what the duties are and how to carry them out in the most proficient and capable way or risk personal liability.

This article was written by Deborah A. Castellani, CFA and William C. Conrad with OTB Strategic Consulting, Inc. and Akros investments, Inc.

Ms. Castellani and Mr. Conrad have more than 50 years of experience working with ERISA Plan providers to deliver strategies and programs that help Plan Sponsors, Plan Fiduciaries and Plan Participants to understand and mitigate the complexities of making and documenting Plan decisions. For information as to how Akros can help you with your duties as a Fiduciary, please see Fiduciary Assessment at <http://www.akrosinv.com/Services.html>.

This material is provided by Akros Investments, Inc for informational and discussion purposes only. Plan Sponsors and others should consult their own counsel and designated advisor, if applicable, for specific guidance on their particular circumstances. The analysis and opinions provided may not be relied upon as investment, tax or legal advice and may change without notice. Statements of fact are from sources considered reliable but no representation or warranty is made as to their completeness or accuracy.

Federal Laws or State Laws of a specific State may be relevant to a particular situation or your retirement plan/s in general and may affect the applicability, accuracy, or completeness of this information. Federal and State laws and regulations are complex and are subject to change. You should consult with an attorney or a designated advisor concerning your role as a Fiduciary.

©2011 OTB Strategic Consulting, Inc. and Akros Investments, Inc. All rights reserved.