



The Investor Advocate[®]

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The Fiduciary Challenge

The Employee Benefit Research Institute (EBRI) is a Washington, D.C. based organization whose mission is “...to enhance the development and enhancement of sound employee benefit programs and sound public policy through objective research and education.”¹ Throughout its history, EBRI publishes a number of studies on various benefit related topics, including the overall growth qualified retirement plan assets and the changes in the component plans generating those assets.

Coinciding with the date of the latest EBRI study, total assets in U.S. retirement income plans as of year-end 2005 amounted to nearly \$15 trillion. This includes both defined benefit and defined contribution plans. Private defined contribution plans accounted for 21% of this amount while private defined benefit plans accounted for 15%. Approximately 19% of retirement assets were in government plans. IRAs and individual insured plans made up the remainder.

These enormous pools of investable assets and the obligations that they are intended to fund have brought with them special responsibilities, requirements, and duties. This is the essence of the fiduciary’s challenge with regard to retirement plans, other employee benefit plans, and the oversight of the investment assets in them.

Fiduciary Duty—History and Background

Beginning in the early 1800s, retirement plans were established by U.S. organizations. Since that time, tens of thousands of working people have received tens of millions of dollars in retirement benefits. The growth and popularity of this area resulted in cases of abuse and an increasing volume of litigation. Naturally, government regulations followed. It was with the enactment of the Employee Retirement Income Security Act of 1974 (ERISA) that protection of plan participants was emphasized.

The Department of Labor (DOL), the Internal Revenue Service (IRS), and the Pension Benefit Guaranty Corporation (PBGC) are responsible for enforcing ERISA. While both the DOL and IRS have the authority to audit and investigate retirement plan compliance, the DOL is the governmental agency primarily responsible for enforcing fiduciary compliance.

Government regulations and regulators take their responsibilities under ERISA very seriously. Thus, fiduciaries that breach their fiduciary duties may be found personally liable under the law, and be assessed penalties to restore plan assets. Fiduciary actions can, among other things, lead to costly plan disqualifications.

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Advocating Your Success

Who Is a Fiduciary?

According to *Black's Law Dictionary*, a fiduciary is "...a person or institution who manages money or property for another and who must exercise a standard of care in such management activity imposed by law or contract."²

ERISA specifically states that there are two classes of fiduciaries—"named fiduciaries"³ and general fiduciaries. Named fiduciaries include the named fiduciary of a single employer plan, the trustees of a Taft-Hartley plan, and the trustee(s) of a single employer plan.

A general fiduciary, except as provided in ERISA Section 3 (21)(B), includes one who:

1. ...exercises any discretionary authority or discretionary control respecting the management of such plan or exercises any authority or control respecting the management and disposition of its assets,
2. ...renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of such plan, or has any authority or responsibility to do so, or
3. ...has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under Section 405(c)(1)(B).⁴

Legislative history and precedent have led to broad and expansive application of some of these terms and the responsibilities within functional areas. Competent ERISA legal counsel should be sought to explain the intricacies and implications of being a fiduciary under ERISA. While certain functions, such as actuarial, recordkeeping, investment management and accounting, may be delegated to others, the ultimate responsibility to oversee and monitor these service providers remains with the fiduciary.

Investments and the Prudent Expert Standard

The area of investments is usually one of great concern for fiduciaries. The responsibility for large sums of money can seem overwhelming. ERISA furthers this concern by stating that fiduciary duties should be discharged "...with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."⁵

The *prudent expert standard* elevates the level of care that fiduciaries must apply to their duties beyond that of the *prudent man standard*. Because most fiduciaries are not familiar with such matters, experts generally agree that, except in the most unusual of situations, the prudent course of conduct by fiduciaries of a plan is to appoint investment managers and to engage professionals to assist them in monitoring their investment managers.

Delegation of Duties

"If an investment manager or managers have been appointed...no trustee [fiduciary] shall be liable for the acts or omissions of such investment manager or managers, or be under any obligation to invest or otherwise manage any asset of the plan which is subject to the management of such investment manager."⁶ This allows fiduciaries to delegate the responsibilities for investments to qualified investment managers and offers them a measure of relief, provided that the fiduciaries are prudent in selecting and retaining the investment managers.

This begs the question as to the definition of a prudent selection and monitoring process for retaining an investment manager(s) for employee benefit plans. As noted below, however, the DOL has effectively addressed this issue with the concept that has become known as **Procedural Prudence**.

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Procedural Prudence

A prudent decision-making process is the primary protection for fiduciaries responsible for employee benefit plan investments. Information gathering, research, methods of analytical comparison and documentation are important components of a prudent process to support the decisions of fiduciaries.

In recent years, court cases and the DOL have enumerated in detail the specific contents of a prudent process. These include the need of plan investment objectives, investment guidelines, the process for investment manager selection and monitoring, elaboration on the diversification of assets, the need for independent verification of investment results and the documentation of the process itself.

The DOL guidelines shine a very clear light on the process that is prudent for fiduciaries to follow. In addition, the merits of such a process go beyond compliance and provide the potential to improve the effectiveness of plans and their investments.

Participant – Directed Plans

A basic tenet of most 401(k), 403(b), and other participant-directed plans is that the responsibility for the allocation of investment assets is in the hands of the plan participants. This delegation of asset allocation to participants, or the fact that a plan is purely a defined contribution plan, does not reduce the responsibility of fiduciaries in two key investment related functions, namely:

1. To prudently select and monitor the plan's investments or investment options and
2. To provide information that allows participants to effectively allocate their assets.

Mutual funds and other commingled investments offered in employee benefit plans are often considered by fiduciaries to be practical and easy to communicate to plan participants. Unfortunately, the apparent ease and simplicity of offering such investments may lead fiduciaries into a false sense of security since such offerings are viewed as "products" rather than fulfilling an investment management role in the plan. However, fiduciaries of both defined benefit and defined contribution plans must exercise their duties with the *same care, skill, prudence and diligence of a prudent expert* when selecting all investment management providers and products for the plans that they serve.

Conclusion

So, what should one conclude about these matters? Quite simply, practice procedural prudence. Seek competent ERISA legal counsel and use the resources of an experienced, independent investment consultant to assist with the oversight of investment manager selection and monitoring. If you, as a fiduciary, are required to act as a prudent expert in an area outside your realm of expertise, the prudent response is to seek expert assistance.

The Investor Advocate® is not intended to provide legal or investment advice.

¹ EBRI website, November 2007

² Black's Law Dictionary, Fifth Edition, 1979

³ ERISA Section 402(a)

⁴ ERISA Section (21)(A)

⁵ ERISA Section 404(a)(1)(B)

⁶ ERISA Section 405(d)(1)

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