Best Practices of Managing Fiduciary Liability

One of the greatest risks assumed by most employers is the risk involved with sponsoring a retirement plan. There is great fiduciary liability in managing investments and retirement portfolios on behalf of the employees, yet it often lacks the attention warranted. Ignoring the risks of fiduciary liability is comparable to ignoring other liability risks, such as those associated with property and casualty. But while employers would never consider it appropriate to operate without adequate worker's comp and property insurance, the risks of fiduciary liability are frequently not addressed.

The good news for employers is that there are several ways to mitigate the liability of sponsoring a retirement plan for their employees, beginning with hiring prudent investment experts, implementing a defensible due diligence process, and following the compliance guidelines detailed in the Employee Retirement Income Security Act of 1974 (**E.R.I.S.A.**), the Pension Protection Act of 2006 (PPA), and subsequent interpretations and relief provided by the Department of Labor (DOL).

A fiduciary is a person to whom property or power is entrusted for the benefit of another. The word is derived from the Latin word for "something held in trust" and surely "**trust**" is the primary characteristic a person would look for in their fiduciary. A person should inherently have a great deal of

confidence in anyone assuming this fiduciary role on their behalf, and to instill greater confidence legislation provides strict oversight and severe penalties for breach of fiduciary responsibility.

As it pertains to retirement plans, ERISA defines the fiduciary under the "Prudent Man Rule," saying that an employer sponsoring a retirement plan (hence, a plan sponsor) should make decisions as a prudent person would if making informed decisions about his or her own account. And since most plan sponsors are not investment professionals or compliance experts, ERISA indicates that the first and most important fiduciary decision an employer makes is hiring an expert to inform or advise them. In other words, the guideline under ERISA is that plan sponsors are always to act in the best interest of the participants, and they are expected to hire a retirement plan specialist for the expertise required. Operating without such a specialist may increase the liability to the plan.

To be certain, under no circumstance is the plan sponsor able to shift the liability completely to this third-party specialist. Even if that investment professional will assume a fiduciary role as a named fiduciary under ERISA 3(38), the trustees of the plan are always the fiduciaries of the plan. But it is possible for some investment professionals, when serving as "co-fiduciaries," to share the liability.

A financial advisor held to a fiduciary standard occupies a position of trust when working with the trustees of the plan. As a fiduciary, the advisor is required to act with undivided loyalty to the client. This includes disclosure of how the financial advisor is to be compensated and any

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corresponding conflicts of interest. To avoid overt conflicts of interest the advisor acting as a fiduciary works on a fee-only basis, and is recognized as a Registered Investment Advisor under the Investment Advisors Act of 1940.

The fiduciary liability is mitigated further if this retirement plan expert designs and builds a documentable due diligence process. In other words, the DOL and IRS are less concerned with the particular investments in a retirement plan than they are concerned a documentable process was followed in selecting those investments. Is there an Investment Policy Statement in place? Is there a regular and consistent review of the investments? Is there a Retirement Plan Committee that regularly reviews the plan the investments? These regular meetings should be documented and minutes should be signed and filed to demonstrate prudence and oversight of the process. Plan sponsors should understand that, from a legal perspective, focusing on meeting a retirement income goal does not mean being held accountable for outcomes. Rather, ERISA is designed so that the plan sponsor's obligations are largely procedural.

The employer or plan sponsor may increase their fiduciary liability if they put policies in writing that they fail to follow, but avoiding documenting policies and procedures is nearly as fatal from a liability standpoint. A prudent fiduciary would outline procedures and policies that protect their company and their retirement plan, and then make every effort to document adherence to these same procedures.

For instance, an employer should adopt an Investment Policy Statement to guide their process for selecting and reviewing investments; an employer should adopt an Education Policy Statement™ to guide their process for educating their employees about the plan, and assuring that their employees are not being sold additional insurance products by the plan advisor, which may increase the liability of the employer; and an employer should adopt a Disclosure Policy Statement™ to guide their process for delivery and education of fees and services to the employees and ensure compliance with new legislation [ERISA 408(b)2 and ERISA 404(a)5].

The plan sponsor seeking true relief from the fiduciary liability imposed on them should hire financial professionals that hold themselves out as experts in ERISA and matters of compliance. Under the current atmosphere of litigation and constantly changing legislation, retirement plans need more than merely investment professionals. When trustees hire professionals they should expect to receive proactive and ongoing advice about plan design and regulations to bring the plan into greater compliance. For instance, is the plan receiving the protection provided under ERISA 404(c)? Has the plan implemented the automatic features recommended by the Pension Protection Act?

So while the fiduciary liability for plan sponsors is great, there is relief when hiring the expertise of a professional retirement consultant, implementing a defensible due diligence process, and following the compliance guidelines outlined by ERISA and subsequent DOL opinion letters. ◆

For questions or information regarding any of this material, please contact us directly.

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