

Benefit Insights

Pinnacle
Financial Services, Inc.

A 401(k) Third Party Administrator of
Exceptional Caliber & Experience

A non-technical review of qualified retirement plan legislative and administrative issues

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ERISA Fiduciary Responsibilities

Are you a fiduciary of your company's retirement plan? If you're not sure, it's time to find out because if you are a fiduciary, it is important to know exactly what your responsibilities are.

The Employee Retirement Income Security Act of 1974 (ERISA) imposes rigorous standards on plan fiduciaries, and a fiduciary who breaches any obligation or duty can be held personally liable to make good any losses incurred by the plan resulting from the breach. That means the fiduciary's individual assets are subject to loss in a fiduciary breach suit.

Unfortunately, many employers offering qualified plans to their employees are not fully aware of their fiduciary responsibilities and the potential personal liability. Because the stakes are so high, it is especially important during the current financial market turmoil that all fiduciaries understand their responsibilities to comply with ERISA.

Following is a simplified explanation of who the plans fiduciaries are and their required duties.

Who is a Fiduciary?

A fiduciary is anyone who:

- Is specifically identified in the plan document as a fiduciary;
- Exercises discretionary authority over the management and disposition of plan assets;
- Renders investment advice for a fee; or
- Has discretionary authority or responsibility in the administration of the plan.

When an employer establishes an ERISA plan, it is the initial fiduciary. Typically it is the board of directors or corporate president who decides whether to appoint individuals or committees to be the plan's fiduciaries.

The appointment of a fiduciary is itself a fiduciary act. So, whoever appoints the officers or committee members has a duty to prudently select those persons and to periodically review their work to make sure they are doing their job.

In general, professional service providers offering legal, accounting or auditing, third-party administration or actuarial services are not considered fiduciaries because they do not exercise discretion or control over the plan.

Fiduciary Duties

The primary duty of all ERISA fiduciaries is to act solely in the interest of plan participants and beneficiaries and with the exclusive purpose of providing benefits to them. Other duties include:

- Selecting and monitoring any service providers to the plan;
- Selecting and monitoring the plan's investments;
- Paying only reasonable plan expenses;
- Following the plan documents (unless inconsistent with ERISA);
- Making sure participants receive the information required by ERISA; and
- Filing the necessary government reports.

ERISA prohibits fiduciaries from engaging in a variety of transactions that are inherently tainted by conflicts of interest (referred to as "prohibited transactions"). Specifically, a fiduciary may not engage in transactions with the plan in which he uses plan assets for his own interest, acts for a party whose interests are adverse to the plan or plan participants or receives compensation from a party dealing with the plan.

Fiduciaries can be held responsible for the actions of co-fiduciaries if they knowingly participate in another fiduciary's breach, conceal the breach or fail to take steps to remedy such breach. For example, a fiduciary with knowledge of a breach by another fiduciary must take action to correct it or he will also be held liable for the breach.

Selecting and Monitoring Service Providers

Plan fiduciaries must carry out their duties with the care, skill, prudence and diligence of a prudent person familiar with the matter and acting under similar circumstances. Competent outside advisors can be engaged who possess the expertise and experience in performing the required duties such as third-party administrators. However, the

plan fiduciary's obligations do not end with the selection of a competent service provider because ERISA imposes an ongoing duty to monitor the provider with reasonable diligence.

A formal review process should be established and followed at reasonable intervals to monitor the provider's performance. Details of these periodic reviews should be documented in writing.

Selecting and Monitoring of Investments

ERISA imposes the requirement that plan fiduciaries invest the assets of a qualified retirement plan in a prudent manner with proper diversification to minimize the risk of substantial loss.

If a fiduciary does not have the necessary investment expertise, an outside trustee or investment manager should be hired to explicitly take on this responsibility. However, fiduciaries must exercise prudence in selecting an appropriate investment manager and have a responsibility to review performance as well as the fees associated with the investments on an ongoing basis.

Establishing prudent and diligent written investment policies solely in the interest of participants and beneficiaries can significantly reduce exposure to fiduciary liability.

Investment Policy Statement

An Investment Policy Statement (IPS) is a written document that provides the plan fiduciaries responsible for plan investments with guidelines for selecting, reviewing and changing the plan's investments. Although ERISA does not specifically require an IPS, it is one of the first things that the Department of Labor will ask to see when it audits a plan and will want proof that it was followed.

The IPS is essential in providing the framework for selection of appropriate investments or, in the

case of participant-directed retirement plans, the selection of investment alternatives. It also serves as a yardstick for evaluating and monitoring performance and can provide important documentation that demonstrates the fiduciaries are meeting their fiduciary responsibilities.

Investments (or investment alternatives) should be monitored, at the very least, on an annual basis to ensure that they continue to be appropriate choices. A detailed file, including notes from meetings as well as any reports evaluating investments, will be helpful if a fiduciary ever is required to defend his decisions.

Participant Directed Accounts

Under ERISA section 404(c), plan fiduciaries may be relieved of fiduciary liability for investment choices made by participants if the plan satisfies certain requirements.

Many employers are under the misconception that if their plans are designed to comply with ERISA section 404(c) safe harbor requirements, they have no fiduciary liability. Unfortunately, this is not the case since the plan fiduciaries are still liable for selecting and monitoring the investment alternatives that are made available under the plan.

Poor investment performance is not necessarily a breach of fiduciary responsibility. On the other hand, offering participants investment choices that consistently perform well below their peers may be.

Paying Reasonable Expenses

Plan expenses can generally be paid from the plan assets as long as they are prudent and reasonable and permitted by the plan document. Since these fees directly affect participants' account balances in defined contribution plans, fiduciaries need to continually monitor plan expenses to ensure that they are reasonable in light of the services provided.

Plan Administration and Compliance

While plan investments are at the heart of fiduciary responsibilities, in practice plan fiduciaries more often run afoul of ERISA's other administrative and compliance requirements described below.

Following the Plan Documents

ERISA requires a qualified plan to have a written plan document. From time to time plan amendments are needed due to legislative changes and should be adopted promptly.

Fiduciaries are responsible for overseeing the administration of the plan. They must understand the provisions defined in the plan document and monitor compliance with those requirements including the following functions:

- Verifying that the plan covers the right employees or does not exclude employees who may be entitled to participate in the plan;
- Depositing and investing employee contributions and loan repayments in a timely manner;
- Paying plan benefits;
- Making plan loans; and
- Ensuring the plan is in compliance with applicable compliance testing.

Participant Communications

Fiduciaries must ensure that plan participants and beneficiaries receive adequate information regarding the plan including:

- Summary Plan Description;
- Summary of Material Modifications;
- Individual benefit statements;
- Summary Annual Report;
- Blackout period notice (if applicable); and
- Automatic enrollment notice (if applicable).

Government Reporting

Plan administrators generally are required to file a Form 5500 with the government each year

which includes information regarding the plan's financial condition, number of participants, fees paid to service providers, etc. For larger plans an accountant's report is necessary. Penalties apply for failure to file these forms in a timely manner.

Bonding

As an additional protection for plans, those who handle plan funds generally must be covered by a fidelity bond which is a type of insurance that protects the plan against loss resulting from fraudulent or dishonest acts of those covered by the bond. In general, the bond must be at least 10% of the value of the plan assets but not more than \$500,000. Certain types of plan investments may increase bonding requirements.

Since the bond does not protect fiduciaries to the extent claims are made against them for breaches of fiduciary duty, a separate fiduciary liability insurance policy should be considered as added protection.

Conclusion

Don't put your personal assets at risk. Determine if you are considered an ERISA fiduciary and make sure you understand your duties. Courts have held plan fiduciaries who were completely ignorant of their fiduciary responsibilities personally liable to restore plan losses for breaching their fiduciary duties of prudently investing the plan assets.

Fiduciary duties are numerous and complex. Fortunately, fiduciaries can seek guidance from competent, experienced outside advisors who have experience with these complex rules. Procedures should be in place for evaluating and monitoring these service providers on an ongoing basis.

Having an IPS will greatly reduce the risk of ERISA fiduciary liability as long as it is correctly drafted, implemented and followed. In addition, fiduciary insurance should be considered to provide added protection in case of fiduciary breach.

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