

Who and What is a Fiduciary?

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Since the fall of Enron in late 2001, there is a heightened sense of awareness in the corporate America about the role of a fiduciary. There is news everyday about the breach of fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA). Everyone from New York Attorney General Eliott Spitzer, to the Securities and Exchange Commission (SEC), the Department of Labor (DOL), the National Association of Securities Dealers (NASD), and other regulatory entities are making fiduciary responsibility a priority. This is also exacerbated by consulting firms aggressively “selling their wares” as fiduciaries for a fee. Moreover, the ERISA definition of a fiduciary is very broad. Therefore, it’s not a surprise that employers are confused, seeking clarity and comfort from potential risk as employee benefit sponsors through financial services industry resources.

The potential risk is inherent in all segments of industry from small to mid and large companies alike. ERISA apply strict guidelines because fiduciaries are held to a higher standard and are required to act in the best interests of their plan and its participants. Failure to comply can result in lawsuits from current participants, former participants, and beneficiaries, as well as the Secretary of Labor, Treasury Department, and Pension Benefit Guarantee Corporation (PBGC). The consequences are substantial since the employers, as well as the individual fiduciaries, are at financial and legal risk.

Let’s put things in perspective

The recent headlines relating to failure of corporate responsibilities detracts from the fact that fiduciary standards have been around for many years. For instance, ERISA was enacted in 1974. Companies, tax advisors, attorneys, and outside consulting firms have been aware of these fiduciaries guidelines and applications within the qualified plan environment. Recent high profile lawsuits have brought these standards to the forefront.

How does fiduciary responsibility apply to the nonqualified world? Generally, an ERISA attorney will advise you that nonqualified deferred compensation (NQDC) plans are not subject to the fiduciary rules of ERISA as long as the NQDC plan satisfies specific guidelines. For example, a “top-hat plan” is exempt from most of the substantive requirements of ERISA relating to participation, vesting, funding, and fiduciary responsibility. However, there’s a small minority of attorneys waiting to challenge certain fiduciary duties, especially when the NQDC plan takes advantage of the qualified plan provisions of ERISA or implementation features similar to qualified plans. Thus, it’s always prudent to exercise corporate due diligence (“best practices”) in implementing and sponsoring a NQDC plan, including the documentation and justification of any decision.

ERISA definition of fiduciary for qualified plans

ERISA specifically defines a person or entity as a plan fiduciary if that person:

- Exercises any discretionary authority or discretionary control respecting management of the benefits plan, or disposition of its assets; or,
- Has any discretionary authority or discretionary responsibility in the administration of the benefits plan.

In addition, ERISA requires a retirement plan to have one or more “named” fiduciaries and must be designated in the plan document or in accordance with a procedure described in the plan document. For example, the sponsoring employer and the trustee are always named fiduciaries. A committee appointed to manage the plan under the terms of the plan document is also a named fiduciary.

Important fiduciary standards for qualified plans

At all times and in every action taken on behalf of the plan, a fiduciary must act in accordance with the following demands of ERISA:

- Act solely in the interests of plan participants
- Act with care, skill, prudence, and diligence
- Diversify plan investments
- Act in accordance with the plan document

Other standards are as follows:

- **Exclusive Benefit Rule {ERISA section 404(a)(1)(A) and 403(c)}** - All actions taken by a fiduciary must be for the exclusive benefit of plan participants and beneficiaries, and with an eye toward defraying the reasonable expenses of running the plan.
- **The Prudent Man Rule {ERISA section 404(a)(1)(B)}** - Requires that a plan fiduciary use the "care, skill, and diligence" that would be used by a reasonably prudent person familiar with "such matters."
- **Diversification {ERISA section 404(a)(1)(C)}** - Requires the plan fiduciary to diversify plan investments unless, under the circumstances, it is clearly not prudent to do so. {Note: some "eligible individual account plans" are exempt from this requirement (ERISA 404(a)(2)), notably those designed specifically to permit investment in employer securities.
- **Compliance with Plan Documents {ERISA section 404(a)(1)(D)}** - A fiduciary must follow the provisions of the written plan document - as long as it is consistent with ERISA.

A fiduciary must also monitor the other plan fiduciaries at "reasonable intervals" (a formal procedure with a regular schedule for review is recommended) and in a way that is "reasonably expected" to ensure that it complies with the terms of the plan and the law.

“The usual suspects” - Application in the real world

Employers: As the sponsor of an employee benefits plan, employers are ultimately responsible for the overall design of the plan, such as the categories of employees who can participate and the benefits to be provided. Employers will always be a plan fiduciary. Responsibilities include:

- Determine the plan design, adopt the plan document, and keep the plan document up to date with the ever-changing employee benefit plan laws and regulations;
- Make contributions to or pay benefits under the plan to the extent required by the plan;
- Administer the plan or appoint the plan administrator;
- Appoint the plan's trustee, if necessary;
- Adopt an investment policy, if necessary;
- Hire third parties to assist with the plan, if necessary, such as a third party administrator, a benefits consultant, an actuary, an employee benefits attorney, and an accountant; and,
- Make decisions involving the amendment or the termination of the plan.

Plan Administrator: The plan administrator may be the employer or a committee. If a third party administrator (TPA) is hired, the designated plan administrator employer or committee is responsible for supervising the TPA and making any discretionary decisions with respect to the operation of the plan. Responsibilities include:

- Develop written policies and procedures for the operation of the plan;
- Advise participants and beneficiaries on the structure of the plan, typically through the publication of a summary plan description (SPD);
- Keep track of the participants' eligibility for benefits under the plan;
- Make decisions on benefit claims and the payment of benefits; and
- Assure compliance with the applicable laws and regulations to include maintaining the paperwork for both the employer and any interested government agencies, such as the Internal Revenue Service (IRS), the DOL, and, for certain retirement plans, the PBGC.

Trustee: Most retirement plans are funded through a trust unless the plan is fully insured or a NQDC plan that is funded out of the employer's general assets. A trustee can be an individual or an institution. Designating a trustee does not relieve the employer from fiduciary responsibilities with respect to the investment of the plan's assets since most trustees are directed trustees rather than discretionary trustees. Responsibilities include:

- Invest the plan's assets held by the trust within the guidelines established by ERISA;
- Distribute benefits based on instructions from the plan administrator; and,
- Report to the plan administrator.

Third Party Administrator (TPA): Professional TPAs are hired to alleviate the employer from the daily operational and administrative requirements of maintaining a plan. TPAs are hired to assist the employer, the plan administrator, and the trustee. This role is extremely important because a plan that does not comply with the multitude of laws and regulations can result in adverse tax consequences to the employer and the participants and subject the plan's fiduciaries to personal liability. A service agreement is usually executed to avoid misunderstandings as to the respective roles and their responsibilities. All responsibility ultimately falls on the employer and the plan administrator to make sure that the plan is properly maintained. Thus, the employer and/or plan administrator must make the final decisions and oversee the operation of the plan. Responsibilities include:

- Assist the plan administrator in keeping track of the participants' eligibility for benefits under the plan;
- Provide ongoing recordkeeping;
- Assist and track transfer of plan assets and participant balances;
- Assist the plan administrator in handling benefit claims and the payment of benefits; and

- Assist the employer and the plan administrator with reporting and compliance.

Investment Advisor: An insurance agent, a stockbroker, or other investment professional who has been appointed by the employer, the plan administrator, or the trustee to provide investment advice. The key difference is advice and discretion versus recommendations. An advisor becomes an ERISA fiduciary of the plan unless this person or entity is merely making recommendations with respect to possible plan investments. In most cases, the ultimate decision with respect to the particular plan investment options is made by the employer, plan administrator or participants. A designated investment advisor who is an ERISA fiduciary will provide the following:

- Investment advice to the employer, the plan administrator and the trustees; and,
- In the case of certain defined contribution retirement plans that allow self-directed accounts, provide investment advice to the participants.

Attorney, consultant, and accountant: Similar advice and discretion rules apply in determining whether an attorney acts in a fiduciary capacity to a plan. Attorneys that advise or exercise discretion on the overall strategy and development of the plan itself and overall operation of the plan could be held to an ERISA fiduciary standard. Responsibilities include:

- Provide legal advice concerning the design of the plan;
- Assist with the preparation and review of the plan documents and any amendments to the plan;
- Provide legal advice concerning the operation of the plan;
- Assist the employer and the plan administrator with government audits and investigations;
- Accounting of plan assets unless funded with a trust and or re-assigned;
- Prepare and review tax filings; and,
- Verify the trust financial reports through a financial audit if the plan is funded with a trust and an audit is required.

Who's not a fiduciary?

An individual is not considered a fiduciary if he or she (a) is not a named fiduciary or (b) is not appointed or does not function as a fiduciary. Accountants, attorneys, consultants, and other individuals who perform purely ministerial functions within a framework of policies, interpretations, rules, practices, and procedures made by other persons are not ordinarily fiduciaries. However, they can become functional fiduciaries if they take on any of the fiduciary responsibilities under ERISA. A fiduciary is any person so named in the plan or any person who exercises any discretionary authority or control with respect to the management or administration of the plan or its assets.

It goes back to making sure that all decisions, processes, roles, and responsibilities are documented to avoid any confusion with all the parties involved. Ultimately, fiduciaries will always be at financial and legal risk. However, corporate best practices of exercising due diligence and documenting as required are always great disciplines to mitigating risk.

The information provided is general information for reference purposes only, and should not be construed as advice in any respect. Please consult with your legal counsel or tax advisor in order to assure thorough and proper application of the complex rules that are highlighted here.