



## ***Are You at Risk?***



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*Have you ever wondered if you are a plan fiduciary – or what risk you may face because of your role as a plan fiduciary?*

If you have not thought about this – you should! All too often plan fiduciaries do not understand the scope of their role and the liabilities they may face when they assume this role. As a result, there have been several class action law suits launched over the years that have focused on fiduciaries violating their duties. This could be you if you are not educated on the important distinctions spelled out by Employment Retirement Income Security Act (ERISA).

To help minimize the risk of litigation and possible personal liability that can arise when selecting and monitoring the company's plan, the first step is to completely understand the breadth of the scope of decisions which are defined as fiduciary acts. Since all decisions are fiduciary acts, whether the organization makes the decision to hire a consultant, an investment advisor or investment manager or decides to oversee the plan investments without the assistance of outside professionals, they remain liable to uphold fiduciary duties under the ERISA. So step one is to define duties.

### **ERISA Fiduciary**

One misconception that should be cleared up immediately is that fiduciary status is only dependent on someone's having the formal title. Actually status is also determined by a person's actions, regardless of the title. This means that the ERISA definition takes into consideration not only who is named as the official fiduciary but who it is that actually exercises control and discretion over the plan.

Therefore it is especially important for *everyone* to recognize that according to ERISA, a person is considered a plan fiduciary (based on title and real responsibilities) if he or she:

- Exercises discretionary authority or control over the management of the plan
- Exercises authority or control over the plan's assets
- Renders or has the authority to render investment advice for a fee or other compensation
- Has any discretionary authority or discretionary responsibility in plan administration

Among the most significant duties executed by the fiduciary are:

- Acting for the exclusive purpose of providing benefits to participants
- Defraying reasonable expenses of administering the plan
- Diversifying investments to avoid large losses

### **Limiting Fiduciary Liability**

The good news is that there are options and plan fiduciaries can embrace an approach that will help them avoid court action. Here are some of the more common alternatives:

#### ***Do-It-Yourself***

Instead of outsourcing their responsibilities, many plan administrators are comfortable fulfilling their fiduciary responsibilities on their own which they accomplish by holding regular committee meetings, following a well-defined investment policy statement that clearly states the goals and objectives for the plan's assets, engaging in a carefully fashioned, disciplined process, consistently recording all decisions and documenting all transactions and regularly evaluating manager and fund performance. Because there are no outside parties involved, the fiduciary responsibility is not shared with others and falls completely on the plan sponsor. As such it is essential that they follow the steps above and also have committee members with the investment knowledge and expertise necessary (or who have agreed to pursue the appropriate training and education to become knowledgeable) to make wise and defensible decisions that are consistent with ERISA's "prudent expert" standard.

#### ***Hiring Third Party Assistance***

Under this option, third party investment professionals are hired to assist with investment decisions. Before going down this path, the company's investment committee must acknowledge that:

1. The act of hiring and monitoring an outside expert is a fiduciary decision
2. The fees paid must be reasonable
3. There should be no conflict of interest for the professional and no influence over investment recommendations
4. All decisions must be well-documented

#### ***Hiring a Consultant***

Under certain circumstances, plan fiduciaries may hire a non-fiduciary consultant who is an independent expert with a broad view of the markets who can bring a depth of industry expertise to assist with evaluating the plan investments. In this role the consultant may help with the search for a service provider, determination of the investment lineup and may also offer ideas for the plan design. By taking this additional step of seeking outside expertise, plan proficiency, the sponsors have demonstrated their commitment to ensuring a deliberate process in plan design and monitoring - which may help to reduce risk of litigation. On the

other hand, while the committee retains full responsibility for all decisions and may accept or refuse the consultant's counsel, if the plan sponsors choose to disregard the consultant's recommendations, they could incur risk if they are called upon to defend their decision. But no matter what, as with all of the options listed here, the plan committee must adopt a careful and prudent process when choosing a consultant and must document in writing all of the consultant's suggestions. (This may be even more critical if any of the expert's suggestions and observations are ultimately rejected.)

#### ***Hiring an Investment Advisor Under ERISA***

Occasionally some plan sponsors prefer that the outside consultant serve as a plan fiduciary. In this situation, the consultant – who is an independent expert with industry experience and who has the training to establish the plan's investment lineup - accepts fiduciary status as an investment advisor as defined in ERISA Section 3(21) and agrees to render advice regarding plan assets for a fee or other direct or indirect compensation.

#### ***Hiring an Investment Manager Under ERISA***

Those plan sponsors who want a more aggressive approach to limiting their fiduciary responsibilities, and thus their riskiness, may turn over complete control of their investment lineup – giving the authority to manage, acquire or dispose of any plan asset - to an investment manager who is a registered investment advisor, a bank, or an insurance company qualified to perform services under the laws of more than one state as defined by ERISA Section 3(38).

Under this approach, the liability of the plan committee is limited to selecting and monitoring the investment manager who assumes all fiduciary liability for matters related to selecting and monitoring the plan investments. As the sole decision maker for investment selection and monitoring, the investment manager must acknowledge in writing that he or she is a fiduciary to the plan and going forward the plan sponsor will generally have no say in matters regarding plan investments.

#### ***Purchasing Fiduciary Liability Insurance and Securing Warranties***

**Insurance:** In addition to the opportunities listed above, plan sponsors can opt to purchase fiduciary liability insurance which can cover claims such as breach of fiduciary duty, negligence in connection with plan administration, defense costs, settlements and judgments. This type of coverage is often recommended despite the fact that claims of discrimination, fraud, illegal profiting from the plan and acts before the effective date of the policy are not included in coverage.

**Warranties:** Guarantees and warranties may be offered by investment providers for the purpose of providing some protection against plan losses and litigation expenses resulting from – or related to – a plan's investment offerings.

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In the case of insurance policies and warranties, the fine print often holds key information, so it is always wise to review all documents carefully and gain a thorough understanding of the protection being offered.

## **Conclusion**

Being an ERISA fiduciary carries both professional and personal risk, and in today's litigious environment – given the volatility of the economic landscape and the stock market – it is more important than ever for all plan sponsors to have a deep understanding of their roles and responsibilities as well as an understanding of some optional approaches that may reduce some of their risk.

The scenarios listed here may or may not be applicable to your unique situation so we caution you that no decision should be made without careful consideration and an in depth discussion with your trusted advisors.

## **Citations**

Some of the data included in this article was researched at Vanguard.com. “Mitigating fiduciary liability for defined contribution plan investment decisions” June 2013.