

A Guide to Understanding Fiduciary Responsibility in 401(k) Plans



The following information is intended to be a general educational guide on the subject of fiduciary responsibility and liability. It is not intended to be used as a legal opinion, or serve as legal or investment advice. Please consult an attorney for specific guidance on fiduciary issues.

Focusing on Fiduciary Responsibility

Since their introduction in the 1980s, 401(k) plans have become the most popular retirement plan among both large and small employers. Since 401(k) plans are characterized as “employee pension benefit plans” for purposes of the Employee Retirement Income Security Act of 1974 (ERISA), the individuals responsible for administration and management of 401(k) plans are characterized as “fiduciaries” and are subject to the same fiduciary standards that apply to the fiduciaries of other retirement plans.^{1,2}

ERISA, the federal law that governs the management of retirement plans, was enacted in 1974 to protect the rights of participants and beneficiaries of retirement and welfare plans. Under ERISA, plan sponsors are directed to design and operate their retirement plans in the best interests of their employees. This means the employer, also known as the plan sponsor, acts as a fiduciary on behalf of the employee.

Fiduciary liability and responsibility has been a growing concern among sponsors of retirement plans during the past few years, with three consecutive years of declines in the equity markets and losses incurred by employees of companies like Enron, who held significant amounts of company stock in their retirement accounts. Plan participants who have never experienced declining markets before may become dissatisfied with their retirement account performance. In some cases, they may seek recompense for their losses in court. Consequently, plan sponsors (and their advisors) should be prepared.

Who is a Fiduciary?

Identifying by Function

Whether an individual is a fiduciary is determined based on his/her function with respect to the plan, regardless of job title. While ERISA does not specifically list who plan fiduciaries are, the regulations do provide some guidance based on function with respect to the plan. The following functions are generally associated with fiduciary responsibility:

- **Plan Administrators**
- **Administrative Committees** such as Investment Committees, Retirement Committees, Boards of Trustees, etc.
- **Plan Trustees** (e.g. bank trustees, individuals, committees, etc.)
- **Named Fiduciaries**
Plan documents are required, under ERISA, to identify – either by name or through an appointment process described in the plan document – one or more fiduciaries as “named fiduciaries.” Many plan documents provide for the appointment of a committee to oversee the plan administration and the investments. Typically, committee members are appointed by the Board of Directors or owner. In that case, the committee is the

ERISA plan administrator and its members are the plan fiduciaries. If no committee is appointed, then the individuals who oversee the operation of the plan will be the ERISA administrators and plan fiduciaries. *The members of the board or owner are also fiduciaries since they appoint the committee members; they have the duty to prudently select and monitor the committee members.* Because the named fiduciary need not be an expert in all areas, plan documents usually allow the named fiduciary to hire outside experts. If the fiduciaries act prudently in selecting and monitoring outside experts, this will generally fulfill their fiduciary obligations.

- **Others** (e.g., officers, directors, investment advisors, etc.) In 401(k) plans, officers, directors and committee members of the plan sponsor often fall into one of the first two categories of fiduciary listed above, since they make decisions about plan operation and the selection of the investment options offered to participants under the plan. Further, some service providers, such as registered investment advisors, investment managers, and others who are hired and paid to advise fiduciaries on investment selection and strategies are performing fiduciary functions.³

¹ Applying ERISA Fiduciary Standards to 401(k) Plans, Snell & Wilmer LLP ▪ ERISA § 3(21)(A) ▪ ³ The Top 10 Most Frequently Experienced Fiduciary Problems in 401(k) Plans, by Fred Reish

Who's NOT a Fiduciary

Again, while ERISA does not specifically list who is not a fiduciary, the regulations provide some guidance based on a function performed with respect to the plan. The following functions are generally not associated with fiduciary responsibility:

- Accountants, attorneys, actuaries and consultants

To the extent they do not exercise discretionary authority or control of the plan or its assets, these individuals, generally would not be considered fiduciaries.

- Individuals who perform "ministerial" or merely administrative functions for the plan, but who cannot make decisions about plan assets, policies or interpretations are not fiduciaries. According to regulations, the following can be performed without becoming a fiduciary:⁴

- Apply rules determining eligibility for participation and benefits
- Calculate benefits
- Prepare government agency reporting
- Allocate contributions according to the plan document
- Maintain participant records
- Process claims
- Make recommendations regarding plan administration

- Generally, service providers are not fiduciaries (unless the functions being performed by the service provider are more than ministerial or administrative, falling within the definition of ERISA § 3(21)(A).

- Participants generally are not fiduciaries.

The Investment Professional as Fiduciary

Fiduciary status with regard to a broker or investment advisor usually hinges on the rendering of investment advice. Courts have drawn a fine line between the non-fiduciary activity of selling investment products and the fiduciary function of rendering investment advice. It is unlikely that investment professionals would be considered fiduciaries merely because they sold investment products to be included in a retirement plans investment lineup.

While ERISA's statutory provisions do not specifically address the difference between the sale of investment products and providing investment advice, regulations do provide that investment professionals who, only execute trades or other instructions, are not performing fiduciary functions.⁵ The courts, however, have held in some cases that investment professionals have stepped over the line of sales and have rendered investment advice, thus becoming fiduciaries.⁶

Generally, industry experts believe that whether an investment professional is a fiduciary depends upon how much the plan sponsor relies on the investment professional in making investment decisions. This determination also depends upon whether the individual provides individualized advice based on the particular needs of the plan (a fiduciary act), or provides guidance and information to the plan sponsor to help them make plan decisions (a non-fiduciary act).

⁴ Reg. 2509.75-8, D-2 Q&A ■ ⁵ Reg. 2510.3-21(d) ■ ⁶ The Top 10 Most Frequently Experienced Fiduciary Problems in 401(k) Plans, by Fred Reish, ASPA 2002 Summer Academy

Defining Fiduciary

Fiduciary = any person who:

Exercises any discretionary authority or control over the management of the plan.

1

Exercises any authority or control over the management or disposition of the plan's assets. (i.e., control of retirement funds or the management of the funds and investment options)

2

Renders investment advice with respect to plan funds or property for a fee or other compensation, direct or indirect, or has any responsibility to do so, or

3

Has any discretionary authority or responsibility in the administration of the plan.

4



“Remember that ERISA requires prudent decision-making, not successful outcome.”

David Wray, President
Profit Sharing Council of America
www.401khelpcenter.com

Defining Fiduciary Responsibilities

There are several ERISA rules that generally define the responsibility of a fiduciary.

Prudent Person Rule

Fiduciaries must carry out all duties with the care, skill, prudence and diligence that a prudent person acting in a like capacity and familiar with such matters would use.⁷ This rule would apply when selecting and monitoring investment alternatives for the plan, as well as assessing the performance and service levels of outside providers.

The courts consistently hold that hindsight cannot play a role in determining whether a fiduciary's actions were prudent. ERISA's prudence standard is not concerned with results; rather it is a test of how the fiduciary acted, viewed "from the perspective of the time of the challenged decision" rather than from the "vantage of hindsight." The law does not entitle the participant to hindsight.⁸

Diversification Rule

Fiduciaries should diversify plan investment alternatives so as to minimize the risk of large losses.⁹

To achieve diversification, participants should be provided with a broad range of prudently selected investment alternatives so they can customize their personal portfolio based on their personal risk and reward characteristics and objectives.

Exclusive Benefit Rule

Fiduciaries must discharge their duties for the exclusive purpose of providing plan benefits to participants and their beneficiaries and defraying reasonable administrative expenses.¹⁰

As a result, in discharging their duties, fiduciaries cannot deal with the assets of the plan for their own benefit, even if it benefits plan participants. In addition, fiduciaries may not engage in conflicts of interest – acts that serve their own personal interests, or the interests of the company sponsoring the plan.

Act in Accordance with the Plan Documents

Fiduciaries must discharge their duties in accordance with the terms and provisions of the plan documents and other instruments governing the plan such as trust agreements, except when they violate ERISA.¹¹

97% of plan sponsors strongly agree, or somewhat agree, that seeking to reduce the risk of liability to lawsuits is a priority for 2003.

Source: Plan Sponsor Priorities 2002, Hewitt Associates LLC



What Fiduciaries Shouldn't Do

Due to the wide variety of prohibited transaction rules and their exceptions, fiduciaries should consult an ERISA attorney for guidance on prohibited transactions. However, the following is some general information on what fiduciaries are prohibited from doing.

ERISA prohibits certain transactions between a retirement plan and certain parties regardless of the fairness of the transaction or the benefit to the plan.

Under ERISA,¹² the list of prohibited transactions includes, but is not limited to, the sale, exchange or lease of property between the plan and a party-in-interest;¹³ lending money or other extension of credit between the plan and a party-in-interest; furnishing goods, services or facilities between the plan and a party-in-interest; or the transfer to, or use by or for the benefit of, a party-in-interest, of any plan assets.

In addition, fiduciaries are prohibited from "self dealing" which generally includes:¹⁴

- 1) dealing with plan assets in their own interest or for their own account;
- 2) acting on behalf of a party whose interests are adverse to the interests of the plan or its participants; or
- 3) receiving any consideration for their own personal account from any party dealing with the plan in a transaction that involved plan assets.

If a prohibited transaction occurs, it must be corrected. At a minimum, the fiduciary is personally liable for any plan losses resulting from the prohibited transaction, and must disgorge any profits the fiduciary made on such a transaction.¹⁵

Limiting Liability for Fiduciaries

Fiduciaries should be aware of the following liabilities for breach of his or her fiduciary responsibilities:

- **Fiduciaries can be held personally liable to make good any losses or to restore any profits made through their use of plan assets resulting from a breach in fiduciary duties.**
- Fiduciaries may be subject to removal as a plan fiduciary.
- Penalties up to 20 percent for any amount recovered as a result of an ERISA violation can be assessed. Penalties can be assessed up to six years after the fiduciary violations or three years after the party bringing the suit had knowledge of the breach.
- Willful violations carry personal criminal penalties of up to \$5,000 (\$100,000 for corporations) and up to one year in prison.
- Although ERISA provides for "other equitable or remedial relief as the court may deem appropriate," a participant may not obtain punitive damages from a fiduciary.
- Fiduciaries may also be liable for a breach committed by another fiduciary if he/she conceals the breach; enables the breach; or knows of the breach, but fails to remedy it.
 - A fiduciary is liable for a co-fiduciary's breach of duty:
 - If he or she knowingly participates in, or knowingly attempts to conceal, an act or omission of another fiduciary and knows that the act or omission is a breach.
 - By failure to fulfill his or her fiduciary responsibilities, has enabled another fiduciary to commit a breach.
 - Has knowledge of a breach by another fiduciary (unless he or she makes reasonable effort under the circumstances to remedy the breach).

ERISA prohibits certain transactions between a retirement plan and certain parties regardless of the fairness of the transaction or the benefit to the plan.

¹² ERISA § 406(a) ■ ¹³ See ERISA § 3(14) for definition of party-in-interest ■ ¹⁴ ERISA § 406(b) ■ ¹⁵ ERISA § 409(a)

Limiting Fiduciary Liability

Section 404(c) of ERISA allows a plan to permit participants to exercise control over the assets in their retirement plan account. If the plan allows a participant to direct the investment of his or her account, and the plan satisfies the requirements under the 404(c) regulations, a fiduciary will not be liable for any losses, or for any breach, which results from a participant's exercise of control.

To obtain protections under 404(c) and its regulations, the participants must be given sufficient information to make informed investment decisions and must have a reasonable opportunity to give investment instructions.

The following is a 404(c) requirements checklist that fiduciaries may find useful when trying to comply with ERISA § 404(c):

❑ Offer a broad range of investment options. Experts recommend at least three diversified investment alternatives with materially different risk and return characteristics be offered under the plan. These investment alternatives are often referred to as “core” investments. The plan may offer more than three core investments and may offer investment options in addition to the core investments. However, all the investment alternatives under the plan should be considered in combination to determine if they are appropriate for the plan's participants. An employer stock fund would not be considered as a core investment fund because it only holds securities of the employer.

❑ Allow participants to transfer between core investments at least quarterly, or with a frequency which is appropriate in light of market volatility. More volatile funds may require more frequent fund transfers in order to allow the participants the opportunity to exercise appropriate control over their accounts.

❑ Provide information to participants so they may make informed investment decisions.¹⁶
Under the regulations for ERISA §404(c), a participant must be provided, by an identified plan fiduciary, through a letter or Summary Plan Description, with the following:

- An explanation that the plan is intended to be a 404(c) plan under ERISA, and that the fiduciaries of the plan may be relieved of losses, resulting from investment instructions given by the participant.
- It is important that participants are notified of a plan sponsor's intention to comply with 404(c). Improper notification could negate the protection for any potential investment losses.
- A description of the investment alternatives available under the plan, including a general description of the investment objectives and risk and return characteristics of each investment.
- Identification of any designated investment managers.
- An explanation about how participants can give investment instructions, including any limitations, (e.g., transfer limitations, voting, etc.) as well as receive written confirmation of instructions provided upon request by the participants.
- A description of any transaction fees and expenses which affect the participant's account.
- The name, address, and phone number of the plan fiduciary or other designated person responsible for providing certain information detailed below.
- A copy of the most recent prospectus provided to the plan regarding its investment alternatives, either immediately before or after a participant's initial election into an investment. Subsequent to such investments, any materials provided to the plan, relating to the exercise of voting, tender, or similar rights to the extent such rights are passed through to participants.
- Any materials provided to the plan relating to the exercise of voting, tender or similar rights of company stock, if offered under the plan, including procedures for maintaining the confidentiality of purchase and sale information.

¹⁶ Reg. 2550.404c-1



In addition, the participant must be able to obtain the following UPON REQUEST:

The annual operating expenses of each investment alternative, which reduces participants' rate of return and the aggregate amount of such expenses as a percentage of average net assets of the investment alternative.

Copies of any prospectuses, financial statements, reports, and other materials relating to the investment alternatives provided to the plan.

A list of the assets in the portfolio of each designated investment alternative and the value of each asset.

Information concerning the value of shares or units in designated investment alternatives.

Information disclosing the value of shares or units, available to participants under the plan, in addition to, past and current investment performance of designated investment alternatives.

Despite compliance with ERISA §404(c), plan fiduciaries still have the responsibility for monitoring the investment options made available to participants to insure that the investments meet the criteria for the asset class and style and are performing well enough to continue to be offered to participants. If one or more of the investment vehicles fails to meet the plan's criteria, (as set forth in the investment policy statement), the fiduciaries may want to remove or replace them. Failure to remove a poorly performing or inappropriate investment option may be found to be a fiduciary breach under ERISA and may result in the fiduciaries being held personally liable for any resulting losses.

Plan sponsors can potentially limit their liability with respect to investment alternatives under the plan by following the guidelines under ERISA §404(c).

Voluntarily Complying with 404(c)

Compliance with ERISA §404(c) is completely voluntary. If a plan does not seek compliance with 404(c), then it falls under the standard fiduciary rules applied by the Department of Labor (DOL). This means that plan fiduciaries could be held responsible for participant decisions as though the fiduciary made them.

However, this issue has not been litigated so it is uncertain how the courts would rule. If participants have access to an "adequate" number of investments and basic information, one might believe that the participants would share some responsibility for the investment decisions they make.¹⁷

¹⁷ plansponsor.com

"A statement of investment policy designed to further the purposes of the plan and its funding policy is consistent with the fiduciary obligations set forth in ERISA §404(a)(1)(A) and (B)."

Interpretive Bulletin 2509.94-2

Investment Policy Statements

While a plan is not required to have an investment policy statement, ERISA encourages fiduciaries to set a policy in writing for the selection and monitoring of investment options. Creating an investment policy statement can help document that an employer is meeting its fiduciary responsibility under ERISA.

An investment policy statement provides fiduciaries with guidelines or general instructions to evaluate and monitor various types or categories of investment management decisions and investment alternatives. If fiduciaries follow the investment policy statement in selecting a plan's investments and monitoring plan investment performance, it is more likely that fiduciaries will be protected in the event of losses. While this is always an important factor, it becomes particularly important in times of volatile markets.¹⁸

An important part of any investment policy statement is to include guidance for monitoring the investment performance of the investment options.

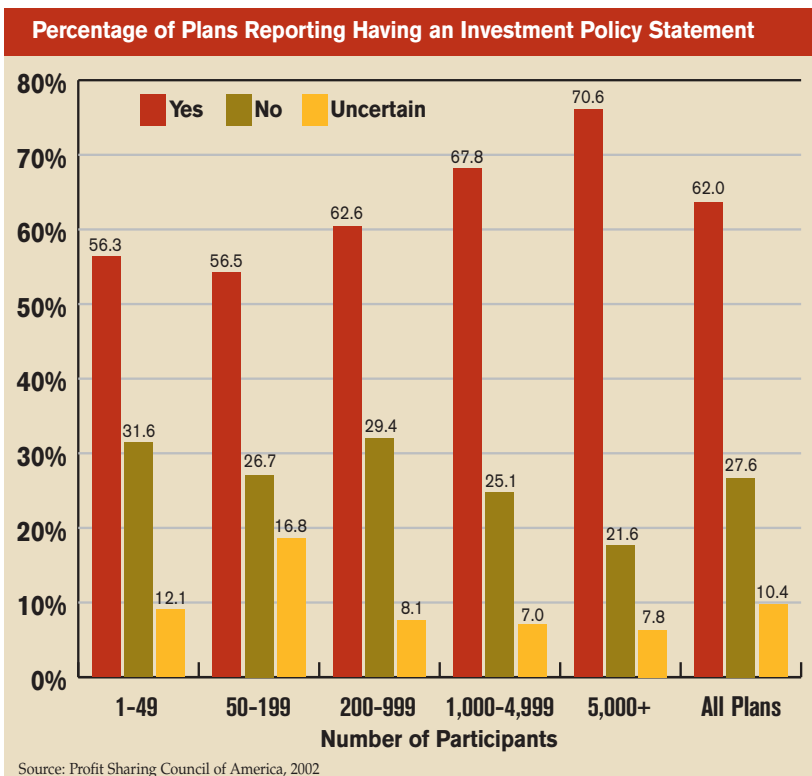
Industry professionals recommend that, at least annually, fiduciaries should compare the plan's investment performance to appropriate market indices to determine if the plan's investments are appropriate given market conditions and the guidelines set forth in the investment policy.

Investment policies vary from plan sponsor to plan sponsor, but the following are some general provisions the Profit Sharing/401(k) Council of America recommends to be included:

- A mission statement outlining the plan's investment purposes and goals.
- A declaration that all parties involved with the administration and management of plan assets are expected to adhere to professional fiduciary standards.
- A clause indicating whether the plan is intended to comply with ERISA § 404(c).
- A statement on the purpose of the Investment Policy Statement and the plan's philosophies and processes for selecting, monitoring, and evaluating plan investments.
- Roles of those involved with plan investments and a summary of their responsibilities. If the plan has an investment committee, its composition should be identified and the scope of its role described.
- Procedures to be used to monitor the plan's investment performance, direction as to how managers should report performance, and a review schedule.
- Guidelines for replacing plan investments and investment managers.
- A statement that, if a conflict arises, the plan document provisions have precedence over investment policy provisions.

Once an investment policy is established, the employer or investment committee should monitor and revise the policy as needed.

(The Profit Sharing/401(k) Council of America is a non-profit association advocating increased retirement security through profit sharing, 401(k) and related defined contribution programs.)



¹⁸ Texas Pension Consultants

Selecting Investments

Under ERISA,¹⁹ a fiduciary must choose investment alternatives for a retirement plan by acting with the care, skill and diligence of a prudent person acting in a like capacity and familiar with investments.

After evaluating the possible investment options to offer participants, fiduciaries should believe that each option will perform well relative to its peer group.

The investment evaluation should be well documented and maintained in a fiduciary due diligence file.

“...the Prudent Man Rule — is one of conduct, and not a test of the result of the performance of the investment. The focus of the inquiry is how the fiduciary acted in his selection of an investment, and not whether his investment succeeded or failed.”²⁰

The investment alternatives chosen for the retirement plan should meet the needs of the particular workforce covered by the retirement plan. The appropriateness of the investment alternatives in relation to the workforce can be evaluated based on several issues, including but not limited to, level of investment knowledge within the workforce, age of the workforce, and literacy levels within the workforce.

In addition, ERISA provides that a fiduciary should diversify the investment alternatives to minimize the risk of large losses unless it is clearly prudent not to do so.²¹ This will allow participants to choose investments that enable them to create an investment line-up for their retirement plan benefits that meets the participant’s personal risk/return criteria and objectives.

Depending on the characteristics of the workforce, a fiduciary may want to include asset allocation funds or models if the workforce does not have the investment knowledge or the desire to direct the investment of their account among the plan’s investment alternatives.

In the initial selection of the plan’s investments, the fiduciaries should review information about each investment alternative (e.g., performance, fees, investment style, risk, etc.) just like a prudent, long-term investor would do.

When monitoring the investments, fiduciaries should periodically assess each investment’s performance as well as other characteristics, using evaluation guidelines set forth in the plan’s investment policy statement.

Investment alternatives that are not performing satisfactorily should be removed, despite participant’s affinity for such funds. Because circumstances like the economy, financial markets, world events, etc. may change, plan sponsors must respond and adapt to those changes in order to meet their fiduciary responsibilities.

There are several criteria fiduciaries often consider when evaluating plan investments, including:

- Performance: one-, three-, five- and 10-year performance relative to the funds peer group and/or benchmark
- Risk adjusted performance
- Fees - expense ratio relative to the investment’s benchmark and other costs
- Style consistency
- Risk and volatility
- Portfolio manager tenure and turnover

Failure to obtain and review this information may be considered a breach of fiduciary duty.

ERISA does not impose a duty of clairvoyance on fiduciaries. Whether the fiduciary has acted properly in making a decision about investments depends upon the circumstances at the time when the decision was made and not upon subsequent events.



¹⁹ ERISA § 404(a)(1)(B) ■ ²⁰ Donovan vs. Cunningham, 716 F2d 1455,1467 (5th Cir. 1990) ■ ²¹ ERISA § 404(a)(1)(C)

According to the 45th Annual Survey of Profit Sharing and 401(k) Plans by the Profit Sharing/401(k) Council of America, 11.4% of all plans and 7.7% of all plans offer participants a Self Directed Mutual Fund Window or Self Directed Brokerage Option, respectively. In addition, less than 5% of participant balances are invested in a Self Directed Option.

Self-Directed Brokerage Accounts (SDBAs) and 404(c)

In addition to the investment options that fiduciaries make available to participants, some plans offer a self-directed brokerage account option (SDBA). This option is generally offered to meet the demands of sophisticated investors who want more choices and greater control. However, some fiduciaries may decide to not offer SDBA due to concerns that less sophisticated participants, who may already feel overwhelmed by the array of investment options available, will make poor investment choices if given access to SDBA.

The question of whether a fiduciary can rely on ERISA 404(c) protection with regard to investment in SDBAs has not been definitively answered by the DOL or the court system. However, some believe that if the investments options available to participants under the plan are not limited to a designated set of investment options, (i.e. if they include a SDBA) then the individual investments potentially held within the SDBA do not need to be prudently selected and monitored by the fiduciary. It is only the choice of offering the SDBA that is evaluated under 404(c) compliance and not the investments within the SDBA that a participant may choose as investments that must meet 404(c) compliance. If this analysis were determined to be correct, there is still the issue of whether a fiduciary can provide participants adequate information on the investment options, as required by 404(c), under a SDBA.

Among the issues that fiduciaries may want to consider in deciding whether to offer a SDBA are: the investment sophistication of the workforce; the scope and effectiveness of the investment education programs; whether investment advice is made available to participants, and the communication needed to inform participants of the risk.²²

Fiduciary Liability Insurance and Bonding

Purchasing fiduciary liability insurance can protect the plan against losses, *but does not protect the fiduciary for breach of duty.*²³ Generally, the insurance covers the plan or trust; past, present and future trustees; plan employees; the company, and any employees who are acting as fiduciaries. In addition, ERISA requires that every fiduciary and person who handles funds or property of the plan be bonded.²⁴

Some suggestions for selecting fiduciary insurance policies are:²⁵

- Policy should define wrongful acts.
- Check that the deductible applies to a single act, or interrelated acts, not each claim for an act.
- To personally cover fiduciaries, the policy must include a waiver of recourse provision. (The premium for this waiver cannot be paid out of plan assets.)
- Should include severability clause to prevent dishonesty of one fiduciary.
- For greater protection, consider buying a separate policy for defense costs, or adding a "defense outside the limit of liability" endorsement to the policy.
- Check the policy for defense costs for allegations of discrimination and other claims generally excluded from indemnity coverage.
- Consider an endorsement to pay DOL or IRS penalties, taxes, fines or sanctions levied for breach of fiduciary responsibility.

²² Reish Luftman McDaniel & Richter/401khelpcenter.com ■ ²³ ERISA § 410(b) ■ ²⁴ ERISA § 412(a) ■ ²⁵ Retirement System Group, Inc. Employee Benefit Advisory, Spring 2002

Understanding Automatic Enrollment

Automatic enrollment is a plan feature that, generally, is used to increase retirement savings for employees and in some cases, help the plan pass non-discrimination testing. With automatic enrollment, new hires are automatically enrolled in the plan at a pre-determined deferral rate (the industry average is a 3% deferral rate) and the employee must elect NOT to participate in order to stop deductions from their pay. When the employee is automatically enrolled, the plan specifies a default investment where the contributions will be invested until the participant changes the election.

The DOL has indicated that ERISA § 404(c) protection is NOT available if the participant does not direct the investment of his or her account (i.e., the account remains in the default investment). Therefore, fiduciaries are responsible for selecting the investments for the account and monitoring the investment to determine if it is and continues to be prudent. Plan sponsors may want to communicate with participants who have never changed their investment election from the default investment and encourage such participants to direct the investment of their accounts.²⁶

Timely Deposit of Employee Deferrals²⁷

The DOL regulations provide that...."the assets of a plan include...amounts that a participant has withheld from his wages by the employer for contributions to the plan as of the *earliest date on which such contributions can reasonably be segregated from the employer's general assets.*"²⁸

The regulation also states that the maximum time period for contributions to be deposited is no later than the 15th business day of the month following the month in which the amounts would otherwise have been paid to the employee or the amounts are received by the employer. This, however, is not a safe harbor and does not mean that contributions deposited by this date are made in a timely

manner. This date is simply the maximum time an employer has to make a deposit, but if contributions can reasonably be made before this date, the regulations require an employer to do so. In fact, the DOL recently modified Form 5500 (Annual Report/Return of Employee Benefit Plan) to prevent employers from relying on the 15th business day rule to deposit employee deferrals.

When contributions, including employee deferrals and loan repayments are considered plan assets, they become subject to all the requirements of ERISA, including the requirements that the assets be held in trust, that the plan fiduciaries take on various duties with respect to those assets and that they are subject to prohibited transaction rules of ERISA. (i.e., see previous prohibited transaction section.)

In a plan audit, the DOL may examine the pattern of when the deferrals were deposited in a plan, and assert that the timing of the most promptly deposited deferrals establishes the reasonable time period referenced in the regulations. The DOL may then ask the plan sponsor to justify the contributions that took longer to deposit. Plan sponsors may be able to justify later deposits for reasonable cause such as payroll problems, switching payroll providers, etc. However, as a practical matter, the DOL commonly takes the position that the deferrals could have been transferred to the plan in two weeks or less from the date of deferral.

The consequences of an employer failing to transmit participant contributions to a plan trustee or investment manager by the applicable period described in the regulation may result in the finding of a prohibited transaction and may subject the employer to liability under ERISA.

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²⁶ Fred Reish & DiMeo Schneider Associates L.L.C. ■ ²⁷ ASPA 2002 Summer Academy; The Top 10 Most Frequently Experienced Fiduciary Problems in 401(k) Plans, by Fred Reish and ASPA 2002 Summer Academy; Late Deposits of 401(k) Deferrals, Sungard Corbel ■ ²⁸ Reg. 2510.3-102

“When all is said and done, the plan fiduciary will be judged not on his performance, but on how well he executed the process.”

MCG Management
Compensation Group

Explaining Service Provider Fees and Expenses

The DOL has made clear that fiduciaries need to be aware of exactly what fees and expenses are being charged against participant's accounts and to the plan. In addition, fiduciaries should have documentation that a determination was made and the charges were found to be reasonable. It is likely that fiduciaries would find such documentation beneficial in the event of a plan audit.

The DOL developed a fee disclosure form that can be used by fiduciaries to understand, evaluate and document the fees and expenses being charged by service providers to provide services to a plan. The fee disclosure form can be found on the DOL's Web site, www.dol.gov.

Delegating Services by Investment Advisors/Managers

ERISA permits the delegation of investment responsibilities by appointment to an investment manager.²⁹ To qualify for this delegation, the investment manager must either be a bank, insurance company or investment advisor under the Investment Advisors act or applicable state law.³⁰ Upon delegation, the fiduciaries of the plan will be responsible for selection of the investment manager, but it is unlikely they would be responsible for the results of any particular investment choices made by the investment manager.

For proper delegation to occur, the investment manager must explicitly acknowledge in writing that it is a fiduciary. There must be a written agreement in which the plan grants the manager investment discretion and in which the manager states it will act as an ERISA fiduciary. The plan fiduciaries must be able to demonstrate that they were prudent in the selection of the particular investment manager and in periodically reviewing the performance of the investment manager.³¹

Addressing Company Stock

Historically, company stock has been utilized in 401(k) plans for various reasons such as aligning the interests of employees and employers by providing an ownership interest to the employees, providing the company with capital for development and expansion, and tax deductions, etc. Recently, due to the Enron situation, et al., where participants lost a significant amount of their retirement savings due to a high concentration in company stock, there has been greater awareness of company stock and whether it is an appropriate investment option for retirement plans. *Fiduciaries should be aware that company stock as an investment alternative still falls under the fiduciary due diligence requirements of ERISA.*

Some experts recommend the following considerations for fiduciaries that utilize company stock as an investment alternative within the retirement plan:³²

1. Establish concrete procedures to evaluate the appropriateness of company stock as an investment alternative in the plan. Like any other investment, company stock should be reviewed periodically. Investment policy statements should establish the monitoring criteria.
2. Appoint a special fiduciary – typically someone outside the company such as an investment manager to perform the monitoring function.
3. Consider the demographics of the employees to determine if the level of investment in company stock within the retirement plan is appropriate given the workforce (i.e., older workforce that may be nearing retirement)
4. If employees must reach a certain age and/or service requirement to diversify out of company stock, consider removing or reducing the restriction.
5. If company stock is used to make a matching contribution, convey clearly to participants that making the matching contribution in stock does not represent a

²⁹ ERISA § 402(c) ■ ³⁰ Reg. 2509.75-5, FR-6 Q&A ■ ³¹ benefitnews.com ■ ³² *Plan Sponsor Magazine*, November 200/401khelpcenter.com

recommendation that participants allocate their own contributions to stock. (Research has found that employees tend to invest more of their own contributions to company stock when they receive a matching contribution in stock).

6. Consider other alternatives to matching contributions in company stock, such as matching in cash at a lower percentage, or a combination of cash and stock.

Given the various issues and considerations associated with including company stock as an investment alternative within the retirement plan, fiduciaries are encouraged to consult an ERISA attorney before making any decisions with regard to company stock.

Providing Advice

Recognizing that investment education may not provide participants with all of the assistance they need, some employers are offering participants with access to an advice service.

ERISA does not require that investment advice be offered to participants, who have the right to direct the investments of their accounts. However, some experts believe that under ERISA's general prudence rule, a plan fiduciary cannot fulfill his or her duty to act prudently if they do not make investment advice available to participants. The argument is that if investment advice is available so participants have the opportunity to make use of it, either the investment results will be superior for the participants acting upon the investment advice or, alternatively, the fiduciaries may have an additional defense against participant claims for poor investment performance. *However, regardless of this argument, fiduciaries are still responsible for prudently selecting and monitoring the investment advisor or advice service provider if investment advice is provided to participants.*³³

One of the definitions of a fiduciary under ERISA is the provision of offering investment advice for a fee.³⁴ Thus, anyone hired to provide investment advice to participants, such as a registered investment advisor, is a

fiduciary and is subject to ERISA's fiduciary standards including the prohibited transaction rules.

A person is considered to render investment advice if:

- 1) the person renders advice as to the value of the securities or property, or makes recommendations as to the advisability or investing in, purchasing, or selling securities or other property, and
- 2) the person, (directly or indirectly)
 - a. has discretionary authority or control with respect to purchasing or selling securities or other property, or
 - b. renders advice on a regular basis pursuant to a mutual agreement or understanding that the advice will serve as a primary basis for the participants or beneficiary's investment decision and that the person will render individualized advice based on the particular needs to the participant or beneficiary.³⁵

As previously mentioned, the plan sponsor has the fiduciary responsibility to prudently select and monitor the performance of any investment advice service provider whose services are being offered to participants. In fulfilling this responsibility, it is recommended that fiduciaries investigate the background and credentials of a prospective investment advice service provider before making advice available to participants. While there are no specific guidelines under ERISA for monitoring investment advice service providers, some experts suggest that fiduciaries should:

- 1) determine whether the advice is given in a timely manner;
- 2) be diligent in monitoring changes in advisory personnel; and
- 3) be comfortable with the style of investment advice given, and whether the results of the advice are appropriate for the characteristics of the participant population.

Anyone hired to provide investment advice to participants, such as a registered investment advisor, is a fiduciary and is subject to ERISA's fiduciary standards including the prohibited transaction rules.



³³ The Top 10 Most Frequently Experienced Fiduciary Problems in 401(k) Plans, by Fred Reish ■ ³⁴ ERISA § 3(21)(A)(ii) ■ ³⁵ DOL Interpretive Bulletin 96-1

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This information is for educational purposes only and not intended to serve as investment or tax advice. This information is intended to be a general educational guide on the subject of retirement plan fiduciary responsibility and liability. It is not intended to be used as a legal opinion, or serve as legal or investment advice. Please consult an attorney for specific guidance on fiduciary issues.