An Overview of Fiduciary Responsibilities Under ERISA

By Lisa Van Fleet and Randy Scherer

You've been appointed as a member of your company's Benefit Plan Committee! As you begin, one of the board members asks your opinion on the company's retirement plan. You know you are a "fiduciary," and you have a notion that there are duties with that title, but what does it all mean?

This article will discuss the basics of what the Employee Retirement Income Security Act[1] ("ERISA") requires of fiduciaries, and how to avoid the common pitfalls you might encounter as fiduciaries. This is not an all-inclusive explanation of ERISA or fiduciary duties, but an overview that provides foundational knowledge and point to helpful resources.

I. What's at Stake?

The consequences of breaching fiduciary duties can be harsh, e.g. the $62 million settlement Lockheed Martin paid out in 2015 after its employees and retirees filed suit alleging the company had excessive fees in two of its 401(k) plan offerings and failed to prudently manage some of its investment offerings.[2] Boeing paid $57 million to settle similar allegations.[3] Not only is the potential price tag high for fiduciary breaches, the liability is personal and joint and several.[4]

It's important to consider that fiduciaries are responsible for *employees'* retirement plans. Many employees rely on the retirement plan their employers offer, and mismanagement of that plan can be devastating to them and their families.

II. Who is a Fiduciary?

Under ERISA, a fiduciary is a person who: 1) is the "named fiduciary," as formally designated by the plan; 2) exercises discretion with respect to management or administration of the plan; 3) exercises discretion with respect to the management or disposition of plan assets; or 4) provides investment advice for a fee.[5] The test of whether someone is a fiduciary is functional, focused on those with actual authority and control over the plan.

A person is only a fiduciary when performing a fiduciary function (i.e., exercising authority and control over the plan). Fiduciaries will frequently be employees of the company, so it is vital to recognize when such a person is wearing her employee hat as opposed to when wearing the fiduciary hat.

Fiduciary functions are activities that give rise to fiduciary status, and include:

- Being a plan sponsor;
- Appointing other plan fiduciaries;
- Selecting and monitoring plan investment options;
- Selecting and monitoring third party service providers;
- Interpreting plan provisions;
- Exercising discretion in denying or approving benefit claims; and
- Providing investment advice for a fee.[6]

Conversely, some plan-related activities are purely administrative in nature and do not give rise to fiduciary status, including:

- Application of rules determining eligibility for participation or benefits where the application of such rules does not include the exercise of discretion;
- Calculation of service and compensation credits for benefits;
- Preparation of employee communications materials;
- Maintenance of participants' service and employment records;
- Preparation of reports required by government agencies;
- Orientation of new participants and advising participants of their rights and options under the plan;
- Collection of contributions and application of contributions as provided in the plan;
- Preparation of reports concerning participants;
- Processing of claims; and
- Making recommendations to others for decisions of plan administration.

These actions do not involve exercising authority or control over the plan. Members of the human resources department are typically not

1. Pub. L. 93-406, 88 Stat. 829, enacted Sept. 2, 1974, codified in part at 29 USC Chapter 18. For purposes of this article, citations will generally refer to the United States Code; however, the body may contain references to the ERISA sections.
2. *Lockheed Martin to Pay $62 Million to Settle 401k Lawsuit*, Fortune (Feb. 20, 2015), <https://fortune.com/2015/02/20/lockheed-martin-to-pay-62-million-to-settle-401k-lawsuit/>.
3. Gail Marksjarvis, *Boeing Settles Excessive 401(k) Fee Case for $47 Million*, Chi. Trib. (Nov. 5, 2015), <https://www.chicagotribune.com/business/ct-boeing-401k-settlement-1106-20151105-story.html>.
4. 29 USC § 1109.
5. 26 USC § 4975(e)(3).
6. There is a limited exception for general education advice or the use of a qualified investment advisor. *See Dep't of Labor, Imterpretive BulletinN 96-1, Participant Investment Education* (June 11, 1996),< govinfo.gov/content/pkg/ FR-1996-06-11/pdf/96-14093.pdf>.

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fiduciaries unless they are also plan committee members.

There is a third category of actions in regards to a plan known as settlor functions. These include business decisions about the plan that are not subject to ERISA's fiduciary requirements. Some examples of settlor functions include:

- Establishing a plan;
- Amending or terminating a plan;
- Deciding which benefits to offer; and
- Deciding which groups of employees will be covered under a plan.[7]

The same party may perform fiduciary, administrative, and settlor functions. During committee meetings, these different functions should be discussed separately and labeled appropriately in the agenda and minutes.

III. Core Fiduciary Duties

Under ERISA, a plan fiduciary has six core affirmative duties[8]:

1) Duty to act prudently: Sometimes referred to as the "prudent-man rule," this requires fiduciaries to discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity would use in similar circumstances.[9] This duty focuses on conduct, and emphasizes process over outcome. When examining whether a fiduciary has breached this duty, courts emphasize the fiduciary's conduct, investigative diligence, and whether she acted consistently with the purpose of the plan over results.

In order to meet this duty, fiduciaries should ask questions, discuss alternatives, challenge the status quo, and, when necessary, seek expert advice to make informed choices. Fiduciaries should document the process to demonstrate that conclusions were made on the basis of an inquiry and analysis. Committee minutes should reflect members' engaged discussion of fiduciary decisions and demonstrate adequate research and information.

2) Duty to diversify the assets of the plan: The duty to diversify is intended to minimize the risk of large losses.[10] This duty requires the fiduciary to refrain from investing disproportionately large amounts in a single security or in a single type of security or securities dependent on one locality or industry. Factors to consider include the purpose of the plan, amount of the plan assets, financial and industrial conditions, the type of investment, geographic distribution, distributions as to industries, and maturity date.

Relief is available from the duty to diversify for participant-directed plans, like 401(k)s.[11] When a plan permits the participant to exercise control over assets in individual accounts, and the participant actually does so, any fiduciary of the plan is relieved of liability for investment performance.[12] If a plan offers a Qualified Default Investment Alternative ("QDIA") as a default fund, fiduciaries are relieved of liability for investment performance of amounts defaulted into the QDIA despite the absence of the participant's affirmative investment selection.[13] Plan fiduciaries are still liable for selection and monitoring of the investment alternatives.

3) Duty to comply with the provisions of the plan: This requires fiduciaries to discharge their duties in accordance with the documents and instruments governing the plan to the extent consistent with ERISA.[14] Documents include the plan document, summary plan description, trust agreement, investment management agreements, and investment policies.[15] Fiduciaries should read these documents and ensure all decisions are consistent with them.

4) Duty of loyalty: The duty of loyalty requires fiduciaries to act in the interest of participants and beneficiaries with the exclusive purpose of providing benefits to those participants and beneficiaries.[16] Fiduciaries should refrain from self-dealing, preferring the interests of third-parties, and misleading participants and beneficiaries. Fiduciaries must vigorously pursue the rights of participants and beneficiaries.

5) Duty to pay only reasonable plan expenses: ERISA allows plan assets to be used for two purposes: paying benefits and paying reasonable expenses of administering the plan.[17] The prudent-man rule intersects this duty, as fiduciaries must identify fees and ensure they are reasonable. ERISA regulations require most plan service providers to disclose fees to plan fiduciaries.[18]

"Excessive fee" cases against fiduciaries of defined contribution plans are common in recent years. Claims in these cases allege that fiduciaries failed to understand, consider, monitor, or disclose revenue sharing payments by fund managers to service providers; that revenue sharing fees and other fees paid to service providers are excessive; or that fiduciaries failed to select the least

7. The Department of Labor has offered guidance on settlor functions, which cannot be paid for using plan assets, through the use of several hypothetical fact patterns. *U.S. Dep't of Labor, Guidance on Settlor v. Plan Expenses*, <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/advisory-opinions/guidance-on-settlor-vplan-expenses>.
8. 29 USC § 1104(a)(1).
9. 29 USC § 1104(a)(1)(B).
10. 29 USC § 1104(a)(1)(C).
11. *IRS, Retirement Topics: Participant-Directed Accounts*, <https://www.irs.gov/retirement-plans/plan-participantemployee/ retirement-topics-participant-directed-accounts>.
12. The requirements of 29 USC § 1104(a)(1)(c) must be satisfied for the fiduciary to take advantage of this relief.
13. *U.S. Dep/t of Labor, Fact Sheet: Default Investment Alternatives Uuder Participant-Directed Individual Account Plans* (Sept. 2006), <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/ default-investment-alternatives-under-participant-directed-individual-account-plans>.
14. 29 USC § 1104(a)(1)(D).
15. In addition, ERISA requires a bond be purchased to protect the plan against losses that result from fraud or dishonesty. *See* 29 USC § 1112.
16. 29 USC § 1104(a)(1)(A)(i).
17. 29 USC § 1104(a)(1)(A)(i)-(ii).
18. *See U.S. Dep't of Labor, Fact Sheet: Final Regulation Relating to Service Provider Disclosures Uunder Section 408(b)(2)* (Feb. 2012), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/factsheets/ final-regulation-service-provider-disclosures-under-408b2.pdf>.

expensive funds. The court will determine whether fiduciaries exercised procedural prudence with respect to fees; if not, the court will then determine if the fees were in fact excessive.

Results in these cases are mixed. Many courts followed *Hecker v. Deere & Co.*,[19] where the court found that because the plan offered a sufficient mix of investments, the inclusion of some expensive funds did not constitute a fiduciary breach. The court in *Loomis v. Exelon Corp.*[20] stated "[n] othing in ERISA requires fiduciaries to scour the market to find the cheapest possible funds." Conversely, in *Tussey v. ABB, Inc.*,[21] the plaintiffs alleged fiduciary breaches based on excessive fees and failure to monitor recordkeeping costs, and the 8th Circuit awarded the plaintiffs $36.9 million in damages. Many "excessive fee" cases, like *Tussey*, end in settlements.

6) Duty not to engage in certain prohibited transactions: ERISA and the Internal Revenue Code prohibit certain prohibited transactions between employer sponsored retirement plans and "parties in interest."[22] For this purpose, a party in interest includes any plan fiduciary,[23] counsel, or employee of the plan; any person providing services to the plan; and an employer or employee organization whose employees are covered by the plan.[24] Specifically, fiduciaries are precluded from causing a plan to engage in a transaction which constitutes a direct or indirect:

- Sale, exchange, or lease of any property between the plan and a party in interest;
- Lending of money or other extension of credit between the plan and a party in interest;
- Furnishing of goods, services, or facilities between the plan and a party in interest;
- Transfer to, or use by or for the party in interest, of any assets of the plan; or
- Acquisition, on behalf of the plan, of any employer security or employer real property in violation of ERISA § 407(a).[25]

A plan fiduciary may not deal with the assets of the plan in her own interest or for her own account, act in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or its participants or beneficiaries, or receive any consideration for her own account from any party dealing with the plan in a transaction involving assets of the plan.

Some transactions which would otherwise meet the definition of a prohibited transaction are exempt, and therefore permissible.[26] These exemptions include:

- Arrangements for office space or services necessary for the establishment or operation of the plan;
- Compensation paid to plan fiduciaries, serving in a dual capacity, for services provided to the plan;
- Investments in mutual funds whose investment adviser is a plan fiduciary; and
- Purchase of insurance or annuity contracts from an insurance company that is a party in interest.

III. Liability and Civil Penalties

When a fiduciary breaches a duty, ERISA imposes personal liability to reimburse the plan for losses resulting from the breach and to restore to the plan any profits made through the use of plan assets by the fiduciary.[27] The court may provide such other equitable or remedial relief as it deems appropriate, although punitive damages may not be imposed. These remedies are available to individuals seeking personal losses in defined contribution (individual account) plans.[28]

Liability for breaches of fiduciary duty committed by co-fiduciaries may be joint and several if a fiduciary knowingly participates in or acts to conceal an act or omission of another fiduciary with the knowledge such act or omission is a breach.[29] Joint and several liability may also apply if a fiduciary's failure to comply with her duties enables another fiduciary to commit a breach, or if a fiduciary has knowledge of another fiduciary's breach and fails to make reasonable efforts under the circumstances to remedy the breach.[30]

In instances of fiduciary breach, the Department of Labor is required to assess civil penalties equal to 20 percent of the applicable recovery amount.[31] The applicable recovery amount is the amount paid by the fiduciary with respect to a breach which is made pursuant to a settlement agreement with the DOL or ordered by a court in a proceeding instituted by the DOL.[32] The DOL retains sole discretion to reduce or waive this penalty upon determination that the person either acted rea-

19. 569 F.3d 708 (7th Cir. 2010).

20. 658 F.3d 667 (7th Cir. 2011).

21. 746 F.3d 327 (8th Cir. 2014). The litigation for this case continued and recently settled for $55 million. *See* Jacklyn Wille, *ABB, Workers Get Early Approval for $55M 401(k) Settlement*, Bloomberg Law (Apr. 3, 2019), <https://news.bloomberglaw.com/employee-benefits/abb-workers-get-early-approval-for-55m-401k-settlement>.

22. 29 USC § 1106; IRC § 4975.

23. E.g., any administrator officer, trustee, or custodian of the plan.

24. 29 USC § 1002(14).

25. The rules regarding prohibited transactions are found at 29 USC § 1106.

26. 29 USC § 1108.

27. 29 USC § 1109.

28. These remedies are not available to individuals seeking personal losses in defined benefit plans; rather, recovery is limited under 29 USC § 1132(a) to claims brought on behalf of the entire plan. The U.S. Supreme Court recently heard arguments on whether a fiduciary has exposure for breach in the case of a defined benefit plan that is fully funded and to which the participant seeking injunctive relief cannot demonstrate individual financial loss or an imminent risk of individual financial loss. *See Thole v. U.S. Bank, N.A.*, No. 17-1712 (argued Jan. 13, 2020).

29. 29 USC § 1105.

30. *Id.*

31. 29 USC § 1132(l)(1).

32. 29 USC § 1132(l)(2).

sonably and in good faith or is unable to restore all losses to the plan, participant, or beneficiary without severe financial hardship.[33]

When fiduciaries engage in prohibited transactions, the IRS may impose an excise tax of 15 percent of the amount involved in the transaction for each year in which the transaction continues.[34] If the transaction is not corrected within the taxable period, a second-tier penalty of 100 percent is imposed.[35] The penalty imposed by the DOL will be reduced by the amount of any excise tax paid with respect to a transaction.

IV. Limiting Liability

A fiduciary may limit her scope of fiduciary functions in several ways. She may delegate certain functions to others (e.g., by appointing an investment manager). The design of the plan may also limit the fiduciary scope. In addition, a fiduciary may hire experts to educate and advise her regarding different aspects of the plan. Methods for limiting fiduciary liability are discussed in more detail below.

Insurance and Indemnification

Fiduciary liability insurance is the first line of defense in limiting liability. Insurance may cover liability or loss resulting from the fiduciary's acts or omissions. Be sure to review the policies and exclusion to ensure proper coverage. Insurance should be in addition to the required ERISA bond, which only protects the plan.[36]

The plan may allow others, like the plan sponsor, to indemnify a fiduciary in cases of breach. Plan assets may not be used for this purpose. In addition, plan provisions purporting to relieve a fiduciary of liability for breaches of duty are deemed void as against public policy, and will therefore have no effect.[37]

Procedural Process

There is no liability under ERISA for a procedurally prudent decision, even if the outcome turns out poorly. The ultimate outcome will be relevant in determining damages, when the decision-making process is flawed. Establishing a procedurally prudent decision-making process limits a fiduciary's liability. It's important to document the process and any actions used in carrying out fiduciary responsibilities. Specifically: (i) hold quarterly or semi-annual meetings; (ii) review information and investigate all alternatives; (iii) get help and advice when necessary (from consultants, providers, and advisors); and (iv) keep records and minutes of meetings.

Delegation of Responsibilities

Fiduciaries may designate others who are not fiduciaries to carry out certain fiduciary duties.[38] Plan documents must expressly permit such delegation and provide a procedure for it. Delegation itself is a fiduciary task, and the named fiduciary must act prudently and in the interests of plan participants and beneficiaries in selecting and monitoring the performance of the person selected to perform fiduciary duties. A fiduciary will not be responsible for acts or omissions of a properly and prudently selected (and monitored) designee, unless co-fiduciary liability applies.

Fiduciaries may hire service providers to carry out certain fiduciary duties, assuming delegation is permitted by the plan documents. Selection of and monitoring the service provider are fiduciary functions. When hiring a service provider, a fiduciary should gather information about the firm itself, including its financial condition and its experience with retirement plans of similar size and complexity. The fiduciary should familiarize herself with the quality of the firm's services by inquiring into the identity, experience, and qualifications of the professionals who would handle the plan, as well as researching recent litigation or enforcement actions against the firm. The fiduciary should also inquire into a description of the firm's business practices. Ask how plan assets will be invested, how participant investment directions will be handled, what the proposed fee structure is, and whether the firm has fiduciary liability insurance.

Once the service provider is evaluated, the selection process documented, and a service provider hired, the fiduciary should implement and follow a regular formal review of the service provider. The review process should include reviewing the service provider's performance, analyzing any reports provided by the service provider, monitoring the fees and costs to ensure they are reasonable, asking questions about policies and practices, and following up on any participant complaints. These reviews should be conducted at regular intervals and documented, and, in some circumstances, the service provider should be replaced.

Fiduciaries may hire an investment manager to manage, acquire, and dispose of plan assets. The investment manager's performance should be regularly monitored, and the fiduciary should retain the ability to terminate the arrangement upon short notice. Any appointed investment manager must also acknowledge in writing that it is a fiduciary with respect to the plan and be either (i) registered as an investment advisor under the Investment Advisors Act of 1940; (ii) a bank; or (iii) an insurance company qualified to manage, acquire, or dispose of plan assets under the laws of more than one state.[39]

When appointing other fiduciaries or service providers, consider the role of the board, the composition of the Plan

33. 29 USC § 1132(l)(3).

34. IRC § 4975(a).

35. IRC § 4975(b). For purposes of the excise tax, the taxable period begins on the date on which the prohibited transaction occurs and ends on the earliest of: (i) the date of mailing a notice of deficiency with respect to the tax; (ii) the date on which the tax is assessed; or (iii) the date on which correction of the prohibited transaction is completed. *See* IRC § 4975(f)(2).

36. The bonding requirement is found at 29 USC § 1112.

37. 29 USC § 1110(a).

38. 29 USC § 1105(c)(1).

39. 29 USC § 1002(38).

Committee, and the role of in-house counsel.[40] Ensure all fiduciaries are identified, delineate their functions to limit exposure, and provide training to fiduciaries.

Plan Governance

The plan documents can limit fiduciary liability. Draft the plan language to avoid having a court fill in gaps if any issues arise. Make sure all plan documents, including the plan, any investment policy, the trust, committee charters, and delegations, are consistent with each other and with actual practice. Consider appropriate administrative changes, such as providing investment education and advice and seeking a qualified fiduciary advisor. Finally, consider operating the plan in strict compliance with ERISA § 404(c) and offer a QDIA to ensure safe harbor relief from fiduciary liability for investment outcomes.

Investment Policy Statement

Establish a written Investment Policy Statement ("IPS"), but to limit it to action that will actually be followed. Keep the IPS current to ensure investments are made in a rational manner and further the purpose of the plan and its funding policy. If the IPS contains a policy for monitoring managers or placing them on a "watch list," follow that policy and document any actions taken. If the plan's investment strategy includes alternate investments such as hedge fuds or swaps, make sure these are provided for in the IPS.

Investment Funds Selection

When selecting funds inspect the track records of potential investments to determine if the investments coincide with the firm's designated investment style for that portfolio. Assess the overall performance relative to others following similar strategies. Confirm all information from independent sources. Be sure to investigate the fee structure to avoid potential "excessive fees" issues.

Monitoring Performance of Investment Funds and Managers

Monitoring the funds and any designees is crucial. Periodically review the plan's cash management and short-term investment procedures. Monitor the fund's or manager's brokerage and trading practices: verify the manager's fee computations, consider the quality of securities transaction executions, and be aware of the portfolio and turnover of investments. At least quarterly, review the performance of the plan. Determine whether it complies with the plan's investment guidelines, examine the rate of return, and compare each fund's or manager's results with appropriate benchmarks.

Administration

Paying close attention to the administrative tasks goes a long way towards limiting potential liability. If these tasks are done well, it makes the previously discussed methods of limiting liability much easier. A list of some important administrative tasks includes: develop a record retention policy and maintain records of written and oral communications regarding the plan; limit who has authority to communicate regarding benefit issues; be mindful of ERISA's timing and procedural requirements for communications, reports, filings and claims; and conduct regular plan compliance audits.

Protecting Against Fee Litigation

Because litigation over excessive fees can be quite costly methods for limiting exposure deserve special attention. Consider a legal audit of the plan, as well as a § 404(c) compliance audit to flag potential issues. Periodically review all aspects of fund selection and negotiate the best deal for participants while considering fees, returns, and performance, and document these efforts. Disclose fees required by participant-level fee disclosure regulations, and comply with fee disclosure requirements for Form 5500. Do not let the plan enter into a contract with a service provider without a complete ERISA § 408(b)(2) fee disclosure. Document compliance with fee disclosure rules.

Voluntary Fiduciary Correction Program: When Things Go Wrong

The Department of Labor ("DOL") offers the Voluntary Fiduciary Correction Program ("VFCP") as a vehicle for voluntary self-correction of various fiduciary breaches.[41] The VFCP offers several potential advantages for self-reporters: the receipt of a "no action" letter upon satisfaction of VFCP conditions, no assessment of an ERISA § 502(l) penalty, and potential waiver of the excise tax under the Internal Revenue Code. On the downside, the DOL may reject the correction and assess a penalty, a notice of the violation must be given to participants if seeking a waiver of the excise tax, and the "no action" letter does not preclude civil action or criminal investigation. In the case of delinquent or non-filers of Form 5500, the VFCP offers significantly reduced penalties.

V. Conclusion

Serving as a fiduciary for your company's retirement plan is an important role that can affect many people. Be mindful of what ERISA requires of you. Breaching your duty has the potential to be disastrous.

40. It is generally advisable that in-house counsel not serve in a 40 fiduciary role in order to avoid compromising the attorney client privilege between in-house counsel and thier client/employer under the fiduciary exception to the attorney client privilege.

41. Information on the VFCP can be found at <https://www.dol.gov/agencies/ebsa/employers-and-advisers/planadministration-and-compliance/correction-programs>.