Focus on Fiduciary

Fall 2005

Understanding Your Fiduciary Responsibility and Liability

Implementing a successful risk-management strategy can benefit your plan and its participants, and potentially reduce your exposure to fiduciary liability.

As a plan sponsor and a fiduciary, you are aware that you have responsibilities with respect to your plan. Generally, you have a responsibility to prudently manage your plan solely in the interests of plan participants and beneficiaries and for the purpose of providing plan benefits. It's also your responsibility to diversify plan assets and act in accordance with plan documents.

Regardless of your training or title, when acting in a fiduciary capacity, either individually or on behalf of your employer, you are responsible for knowing your duties and responsibilities and acting accordingly.

By implementing a successful risk-management strategy, you can benefit your plan and its participants, and potentially reduce your exposure to fiduciary liability.

Do you know your role?

The scope of fiduciary responsibility is broadly defined under the Employee Retirement Income Security Act of 1974 (ERISA). ERISA allows for fiduciary duties to be allocated among fiduciaries in the plan's governing documents.

Sometimes individuals may not realize that they're acting in a fiduciary capacity. Even those who have been formally appointed might not be fully apprised of their duties or instructed on how to fulfill them. In general, a fiduciary is anyone who:

- Exercises discretionary control or authority over a retirement plan, regardless of title
- Provides investment advice for a fee or other compensation, either direct or indirect
- Maintains discretionary authority or discretionary responsibility in the administration of the plan

A fiduciary may include:

- A plan sponsor—acting through its appointed officers, employees and committees of same
- A plan administrator—generally, the employer acting through its appointed officers and employees
- A trustee or investment manager

According to ERISA, the duties of the fiduciary must be conducted in the following manner:

- With loyalty: It is the duty of the fiduciary to perform solely in the interest of plan participants and beneficiaries, even if those interests are not necessarily aligned with the rest of the company.

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- For exclusive purpose: The fiduciary must act for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of plan administration.
- With prudence: The fiduciary must follow a documented process that demonstrates establishment and adherence to procedures, which creates a record of actions taken, and discloses the underlying rationale of fiduciary decisions.
- By diversifying investments: For participant directed plans, the fiduciary must provide participants with a spectrum of choices that can help them reach their retirement objectives through a diversified portfolio. For discretionarily managed plans, the fiduciary must establish investment goals and objectives that appropriately diversify the assets of the plan in accordance with plan documents.

Liability exposure of plan fiduciaries may involve claims such as:

- Failure to disclose important information or providing misleading information
- Encouraging participants to invest in company stock when such an investment is not prudent
- Failure to monitor plan investments

Mitigating risk through outsourcing to qualified third parties

Outsourcing doesn't shield fiduciaries from liability, but delegating plan responsibility to qualified third parties can benefit the plan and may ultimately help mitigate fiduciary risk.

Due diligence and prudent monitoring

Fiduciaries should demonstrate that they follow a due diligence process when selecting an outside service provider. Whether that third party is an insurance company, financial institution, or brokerage house, it's important to scrutinize factors such as reputation, experience and performance, as well as the provider's proposed benefit solutions and required contractual agreements. Monitoring of all service providers should be ongoing and well documented.

Managing the managers

As to investment management responsibility, the primary role of the plan sponsor as fiduciary is to oversee the investment process by "managing the managers." This is particularly true when a corporate trustee is given discretion over plan assets or a qualified investment manager is hired to manage the plan assets. Again, you should carefully select the trustee or investment manager(s) and continue to monitor the performance of those parties throughout the life of the relationship. Hiring a corporate trustee or an investment manager is a method of shifting investment management risk to a qualified third party.

Selecting and engaging service providers is itself a fiduciary duty, but if you follow the terms of the plan, exercise prudence in the selection process, and then properly monitor the service provider, you will benefit the plan and mitigate your fiduciary risk.

Strategies for mitigating risk

Be process oriented

First and foremost, establish a process and document it. Create formal procedures for fiduciary action and follow them. Document the reasoning behind each fiduciary decision. Establish appropriate committees and have them meet regularly. Keep minutes of meetings.

Follow ERISA Section 404(c)

If your plan is a defined contribution plan with participant accounts, consider following ERISA Section 404(c), which provides optional strategies for mitigating fiduciary risk. This section shifts investment responsibility to plan participants if, among other things, they are given the opportunity to exercise control over the assets in their accounts, have access to a variety of investment options and receive required disclosures. However, as a fiduciary, you must prudently select and monitor the investment options made available to the plan participants.

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Review and revise your investment policy statement

All plans should have a written investment policy statement. A well crafted investment policy statement assigns responsibilities and defines expectations for all fiduciaries, including the investment managers. It outlines investment goals and objectives, risk tolerance, liquidity needs and tax implications, and describes the unique needs and preferences of the plan. Each fiduciary should have a copy of this document as a reference and procedural guide. It is important to follow the investment policy once it is created because it is a roadmap to fulfilling the plan's objectives.

Think and act like a fiduciary – this is no ordinary corporate function

When choosing a plan service provider, conduct appropriate due diligence. Make a choice that will be best for the plan, not necessarily the least expensive. Going forward, monitor the service providers on an ongoing basis to ensure that their performance is appropriate and that the fees charged to the plan are reasonable and necessary to the plan's administration.

Be proactive when providing guidance to plan participants

You demonstrate due diligence when you provide financial and investment education to help your participants make informed decisions.

A rigorous approach to mitigating risk not only benefits the plan and its participants but also may reduce fiduciary liability. Properly identifying fiduciaries, assessing their abilities, monitoring their progress and developing a formalized structure for the management and administration of the plan can provide solid footing for your risk-management strategy.

For more information on mitigating risk and applying risk management principles to your retirement plan, contact your Bank of America relationship manager.

Additional Resources on the Web:

www.401khelpcenter.com/401k/higgins_fiduciary_charter.html
www.401khelpcenter.com/401k/robertson_fiduciary_education.html
www.financial-planning.com/pubs/fp/20021001017.html
www.benefitnews.com/finance/detail.cfm?id=7556
www.orrick.com/publications/index.asp?action=article&articleID=251
