

## THE DELEGATION OF RESPONSIBILITY FOR 401(k) INVESTMENTS: How board members and officers can maximize their protection against 401(k) fiduciary liability

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If you're someone who is responsible for the management of your employer's 401(k) plan, there's something you should know.

There are 401(k) providers out there who can help you maximize your protection from fiduciary liability.

But before I discuss what's available in the marketplace, let's start with the basics.

### What are a fiduciary's responsibilities?

ERISA (the Employee Retirement Income Security Act of 1974), the main federal law that governs retirement plans, imposes fiduciary responsibility on those individuals who manage retirement plans. The federal agency that oversees the fiduciary aspects of ERISA is the U.S. Department of Labor.

Under ERISA, a fiduciary has a responsibility to protect plan assets and operate and manage the plan in such a way as to protect the interests of participants and beneficiaries.

Fiduciaries are held to standards of conduct under ERISA defining the care, skill and prudence that they must use in carrying out their duties with regard to the plan. These standards require that fiduciaries:

1. Operate the plan for the exclusive benefit of the employees and their beneficiaries.
2. Defray plan expenses in a reasonable manner.

3. Not engage in certain transactions with "parties in interest."
4. Select investments with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.
5. Diversify plan investments.
6. Operate the plan in accordance with plan documents as long as they are consistent with ERISA.

### Who is a fiduciary?

You may not consider yourself a fiduciary, but the Department of Labor, the federal agency that oversees the fiduciary aspects of ERISA, may consider you one nonetheless.

Who exactly is a fiduciary? A fiduciary under ERISA is any person who has discretionary authority over plan assets, exercises discretionary authority over plan administration, or gives investment advice for compensation, either directly or indirectly.

The employer is usually a fiduciary solely on the basis of his/her role as Plan Administrator. By the very nature of the position, he/she has discretionary authority or discretionary responsibility in the administration of the plan.

However, ERISA also employs the concept of *Functional Fiduciary*. This means that someone can be considered a fiduciary even if unintended or unknowingly he/she is responsible for the selection and retention of other plan fiduciaries or exercises discretionary authority and control over plan investments.

### **What are the consequences not fulfilling fiduciary responsibilities?**

The consequences can be quite severe. ERISA says that “Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach...”

### **What is the Prudent Man standard?**

As mentioned above, a fiduciary must select investments with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

In other words, a fiduciary who is responsible for making investment decisions is subject to the standard that would apply to a person familiar with investments. The *Prudent Man Rule* could be better described as the *Prudent Expert Rule*.

Lacking that expertise, then, a fiduciary would want to hire someone with that professional knowledge to carry out the investment of plan assets.

If an employer appoints an investment manager that is a bank, insurance company, or registered investment adviser, the employer is not liable for the individual investment decisions of that manager.

### **What fiduciary services are available from 401(k) providers?**

Since the beginning of 401(k) plans in the early 1980s, 401(k) service providers have introduced an increasing number of services to stay competitive with other providers.

Not surprisingly, most 401(k) plan providers now offer some sort of fiduciary support to help employers manage their fiduciary responsibilities.

While it is important to note that a plan sponsor’s fiduciary responsibilities extend beyond investment selection, the marketplace offers different levels of support for those that need help in determining the appropriate investments for their participants.

Thus, it’s important to understand the differences between the levels of support and services offered by providers.

There are four levels of fiduciary support available from retirement plan providers in today’s marketplace, each offering a different level of support with regard to investment selection and monitoring.

Here is a brief description of each in the order of lowest to highest fiduciary protection:

*1. Due Diligence Support.* Providers offering this service have an evaluation process with regard to the investment options they offer under their retirement programs usually known as due diligence support.

The provider offers a wide array of funds, and plan sponsors use the tool to help construct an appropriate line-up for their plan. However, the plan sponsor is still responsible for selecting and monitoring the plan’s investment options.

*2. Fiduciary Certificate or Warranty.* Providers offering this service provide a Certificate or Warranty that is generally available to plan sponsors if they select at least one fund in designated asset classes.

There is due diligence support for evaluating their funds combined with last-resort fiduciary liability protection if numerous conditions are met.

*3. Acknowledgment as a Fiduciary under Section 3(21)(A)(ii) of ERISA.* Some providers offer the services of an independent registered investment adviser (RIA) who will agree to become an investment advice fiduciary under section 3(21)(A)(ii).

Under this service, the RIA recommends and monitors funds for the plan's fund menu. However, employers are still responsible for selecting and monitoring the specific funds used on the menu.

*4. Acknowledgment as a Fiduciary under Section 3(38) of ERISA.* Some providers offer the services of an RIA who will agree to become an investment advice fiduciary under Section 3(38) and assume all responsibility for investment selection and monitoring.

A Section 3(38) arrangement represents the most comprehensive level of fiduciary support possible under ERISA.

### **Which fiduciary service is best?**

There is a complete range of services that a fiduciary can use to support and maximize his/her protection from fiduciary liability ranging from:

1. Due Diligence Support
2. Fiduciary Certificate or Warranty
3. Acknowledgment as a Fiduciary under Section 3(21)(A)(ii) of ERISA
4. Acknowledgment as a Fiduciary under Section 3(38) of ERISA

There is no "best" one. Each fiduciary must decide based on individual facts and circumstances.

But remember, all fiduciary responsibilities can not be delegated away. The responsibility always remains to monitor the service provider on a periodic basis.

### **About National Benefit Services, Inc.**

National Benefit Services, Inc., founded in 1978, is a Chicago-based firm providing consulting, actuarial, and administration firm for employer sponsored retirement plans. The firm's clients include U.S. employers and foreign companies with U.S. operations.

Jerry Kalish, the firm's President and founder, provides continuing education programs for attorneys, CPAs and the financial services industry.

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