



Taking Charge

Avoiding a fiduciary trap.

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The popular thinking about 401(k) investments seems to be that, if fiduciaries offer a well-selected lineup of mutual funds, their Employee Retirement Income Security Act (ERISA) obligations are satisfied. However, that is changing and, if fiduciaries aren't paying attention, they could fall into a trap for the unwary.

The "trap" is that the fiduciary also must pay attention to how the participants actually are using the investments.

That raises two key questions: Are fiduciaries legally responsible for the prudence of participant investments? If they are responsible, what steps can fiduciaries take to fulfill that responsibility?

In answer to the first question, fiduciaries are responsible for the prudence of participant investment decisions. The decision of the Enron court on September 30, 2003, made it clear that, if a plan does not comply with the 20 to 25 conditions of 404(c), the fiduciaries (for example, the committee members) are responsible for the prudence of the participant investment decisions. To put that in context, our experience is that very few plans actually comply with 404(c). As a result, the fiduciaries of most plans are personally responsible for the prudence of the investment decisions made by participants.

Even if a plan complies with the 404(c) requirements, fiduciaries should evaluate whether it is prudent to continue to offer the current investment education services if they aren't working, or should the fiduciaries insist that their advisers and providers offer workable solutions? Those questions have not been answered in court cases or Department of Labor (DoL) guidance. However, in Interpretive Bulletin 96-1, the DoL stated its position that fiduciaries must monitor the plan's investment educators. Logically, one of the factors to be monitored would be whether the investment education was working.

Some Answers

Because of the lack of answers, the conservative course for fiduciaries is to take a greater role in helping participants invest properly.

Here are some ideas about how that can be done:

- The summary plan description should have a clear statement that, if participants are concerned that they do not know how to invest properly, or if they simply do not want to take on that responsibility, they can default and the fiduciaries will invest their accounts. (ERISA requires that fiduciaries invest employee money under these circumstances. So, this just lets participants know what the fiduciaries already are required to do.) The Pension Protection Act amended ERISA to provide fiduciary protection—perhaps the best in the law—for fiduciaries who use qualified default investment alternatives, or QDIAs, as investments for defaulting participants. In my opinion, any fiduciary who doesn't take advantage of the fiduciary protection for QDIAs simply doesn't understand the law.
- Fiduciaries also should consider an arrangement under which participants are invested in QDIAs initially. For example, a plan could provide that, unless new participants decide otherwise, they will be invested in QDIAs. Since the investment

objective of ERISA's fiduciary responsibility rules is for participants to be well invested, that would relieve fiduciaries of concern about much of their legal responsibilities for the prudence of participant investing. This arrangement could be structured as a default in order to obtain the fiduciary protections of the PPA.

- Similarly, fiduciaries should consider mapping, or defaulting, to QDIAs when a plan switches providers. One provider for mid-size and large plans has been encouraging plans to take that approach. For the plans that have used that process, the average experience is that 75% or more of the participants have gone along with the default. Properly done under the new default rules, that would mean that the fiduciaries are protected under ERISA for the investing of 75% or more of their participants.

ERISA requires that fiduciaries act for the exclusive purpose of providing retirement benefits and with the prudence, care, skill, and diligence of a knowledgeable investor.

In the investment context, the easiest way to satisfy those requirements is for fiduciaries to take a more active role in helping participants invest successfully for retirement. If participants are left to flounder, there is a risk that many will invest improperly and, as a result, their retirement benefits may be inadequate—and, as we know, bad results can lead to litigation.

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