**Managing Plan Assets and Fiduciary liability under ERISA**

|  |
| --- |
| The types of investments available to employee benefit plans have evolved since ERISA’s enactment. The statute wisely refrains from establishing lists of specific securities or other assets that are either permitted or prohibited. Instead, ERISA requires fiduciaries to select investments in accordance with the duty of prudence. That is, with the care, skill, prudence and diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Whether they are involved in selecting mutual fund options for a 401(k) plan’s investment menu or choosing a mix of assets intended to fund lifetime pensions for a specific group of pension plan participants, the duty of prudence is seen by the courts as requiring fiduciaries who have investment duties to engage in a process whereby the merits of each proposed investment are examined before it is acquired and thereafter continuously monitored to ensure that the investment remains suitable.  A fiduciary with investment authority must also diversify the plan’s investments so as to minimize the risk of large losses and discharge his or her duties for the exclusive purpose of providing benefits or defraying reasonable expenses, all in accordance with plan documents to the extent consistent with ERISA. Thus, even where a particular investment is otherwise permitted by plan documents, if making such an investment would violate these standards or constitute a prohibited transaction under ERISA, a plan fiduciary would be prevented from making the investment.  *Benefits and/or Investment Committee*  ERISA provides that a plan’s named fiduciary and trustee have the power to manage plan assets. If a named fiduciary or trustee delegates investment authority to another person, such as a benefits or investment committee, the person to whom such authority is delegated will have full liability as a fiduciary under ERISA. In addition, the named fiduciary or trustee who appoints such a person will be responsible for the person’s conduct unless the appointee is a trustee or an investment manager meeting the requirements of Section 3(38) of ERISA.  Members of a benefits and/or investmentcommittee are fiduciaries if investment responsibilities are delegated to the committee. Therefore, such a committee should carefully document all meetings where the management or disposition of plan assets is acted upon. Written minutes should describe the investigation of proposed investments or investment courses of action, decisions taken and how members voted on each issue. If any members of the committee object to a proposed action because it might violate ERISA’s fiduciary standards, those members objecting to the action should insist that their objections and the responses to their objections be documented in the minutes of the meeting.  A benefits and/or investment committee member may need to resign if another member persists in a course of action that constitutes a breach of fiduciary responsibility. However, the resignation alone may not be sufficient to discharge the member’s duty to make reasonable efforts to remedy the breach.  *Trustees as Fiduciaries*  ERISA requires all assets of an employee benefit plan to be held in trust by one or more trustees who are named in the plan or trust instrument or appointed by a person who is a named fiduciary. Under the statute, the plan trustee or trustees have the exclusive authority and discretion to manage and control plan assets so that a trustee will, by definition, always be a plan fiduciary. Accordingly, a trustee’s responsibilities must be discharged prudently and solely in the interest of the plan’s participants and beneficiaries.  Different trustees may have varying levels of authority or discretion to manage or control plan assets. Thus, the plan document may provide that a trustee is subject to the direction of a named fiduciary. Such a “directed trustee” must follow the directions of the named fiduciary, provided that such directions are consistent with the terms of the plan and are not contrary to ERISA. A trustee’s authority over plan assets may also be limited to the extent that the plan’s named fiduciary has delegated the power to manage, acquire or dispose of plan assets to one or more investment managers.  While directed trustees are fiduciaries, the scope of their fiduciary duties is significantly narrower than the duties generally ascribed to a discretionary trustee. To the extent that a directed trustee’s authority and discretion to manage plan assets has been limited, the named fiduciary’s role and legal responsibility will be correspondingly broadened.  *Investment Manager*  As noted previously, authority to manage and control plan assets may be delegated by a named fiduciary to an investment manager. Such an appointment relieves the plan’s trustee of responsibility for investment matters. Similarly, a named fiduciary will not be liable for the investment manager’s investment decisions, although selection of the investment manager is a fiduciary act and even after the investment manager has been appointed, the named fiduciary remains obligated to monitor the investment manager’s performance.In order to constitute a proper appointment, the investment manager must acknowledge in writing that it is a fiduciary and must be a registered investment adviser under the Investment Advisers Act of 1940. If not so registered, then the investment manager must be registered with the state in which it maintains its principle office. Alternatively, the investment manager may be a bank, as defined under the 1940 Act, or an insurance company qualified in more than one state to manage, acquire or dispose of plan assets. |

**Statement of Investment Policy**

|  |
| --- |
| Although ERISA does not require a plan to have one, DOL guidance indicates that the establishment and maintenance of an investment policy designed to further the purposes of the plan and its funding policy are consistent with fiduciary obligations under ERISA (*i.e*., in the opinion of the Department, fiduciaries should maintain plan investments in accordance with an investment policy).  An investment policy is a written statement that provides fiduciaries responsible for plan investments with guidelines about various types or categories of investment management decisions. An investment policy statement may cover matters such as (i) the plan’s investment objectives, (ii) the roles and responsibilities of particular plan fiduciaries, (iii) standards for selecting, monitoring and changing investment options and (iv) participant communications and investment education. DOL guidance indicates that a statement of proxy voting policy would also be an important part of a comprehensive investment policy statement. ]An investment policy generally does not include directions relating to the purchase or sale of a specific investment.    If a named fiduciary appoints one or more investment managers who are responsible for managing the investment of plan assets, the fiduciary may condition such appointment on the acceptance of an investment policy. In other words, the named fiduciary may require that the investment manager comply with the terms of the plan’s investment policy. This investment policy should contain guidelines for plan investments and investment courses of action that the investment manager is authorized (or not) to make. If an investment manager is not required to comply with an investment policy, the authority to manage the plan assets placed under the control of the investment manager would lie exclusively with the investment manager.]    An investment manager who has the authority to make investment decisions, including proxy voting decisions, is not relieved of his fiduciary responsibility even if he follows directions regarding specific investment decisions from the named fiduciary or any other person.Thus, an investment manager should not comply with the terms of an investment policy if it would cause a breach of his fiduciary duty  .  *Continuous Monitoring*  In accordance with the written investment policy, fiduciaries should continuously monitor plan investments. Ideally, investments should be reviewed periodically at fixed intervals. Monitoring should be guided by the plan’s investment policy and apply an appropriate mix of qualitative and quantitative benchmarks to the performance and expenses of each investment fund or manager. Fiduciaries must make an effort to understand what their analysis means for the plan and the participants. Investment performance must be correlated with current market conditions and compared to the performance and expenses of peer investment providers.  *Utilization of an Independent Third Party Investment Expert*  According to the Department of Labor, “a failure exists in the market for services for employee benefit plans” where vendors are able to maintain an “information advantage over their plan sponsor clients.” There is an inherent conflict of interest that exists when a vendor renders advice that leads to a plan’s investment in the vendor’s proprietary funds or even nonproprietary funds where the vendor has a favorable business relationship with the fund sponsor. Accordingly, while vendors may furnish reports and analyses and make recommendations as to retaining or replacing specific plan investments, plan fiduciaries should understand that this information may be biased. Where a fiduciary does not have the training or experience to recognize this bias, it may be advisable to seek out the advice of an independent third party investment expert. Indeed, it may be necessary to take this step to ensure compliance with the plan fiduciary’s duties under ERISA, and the incorporation of such a requirement in the plan’s investment policy statement should be considered for the same reason.  *Replace Funds That Do Not Meet Investment Criteria*  One of the key functions of an investment policy statement is to provide specific standards that a plan investment must satisfy in order to assist plan fiduciaries in deciding whether actual investments should be retained or replaced. The failure to replace funds that have performed poorly can be used as evidence that a fiduciary has failed to act prudently resulting in personal liability. Nevertheless, many fiduciaries remain reluctant to take action on such funds, sometimes merely adding funds as a substitute. The existence of objective investment guidelines in the form of the investment policy statement assists fiduciaries in the decision-making process and forces a plan fiduciary to act when necessary. |

**Conflicts of Interest**

|  |
| --- |
| ERISA requires plan fiduciaries to discharge their duties “solely in the interest of the participants and beneficiaries” and “for the exclusive purpose” of providing them with plan benefits.The exclusive purpose requirement is supplemented by a rule that “the assets of a plan shall never inure to the benefit of any employer …” and a comprehensive set of prohibited transaction rules designed to prevent self-dealing.[]](http://pro.nuco.com/advisorsguide/ERISAFiduciaryCompliance/ch08/Pages/003-Conflicts%20of%20Interest.aspx#_ftn3) Together, these provisions impose an overarching duty of loyalty requiring plan fiduciaries to avoid conflicts of interest.  Among other things, the duty of loyalty requires a plan administrator, including a plan sponsor when it is acting in the capacity of an administrator, to refrain from misleading participants. In addition, a plan fiduciary, such as a corporate plan sponsor, must not use plan assets for its own purposes in a corporate control contest by investing in the plan sponsor’s stock without making an independent and diligent investigation of available investment alternatives. Similarly, a plan fiduciary will be found to have breached his duty by investing plan assets in a troubled entity that is unable to obtain conventional financing in which the fiduciary has a significant ownership interest.  The heightened scrutiny given to fee arrangements for individual account retirement plans has resulted in a proliferation of legal actions by plan participants against plan sponsors, as well as investment and service providers. They have been charged with a conflict of interest resulting from excessive fees that, in certain cases, are shared by service providers without the knowledge of plan fiduciaries or participants. While a number of courts have rejected such claims, many similar cases remain ongoing. At the same time, the DOL has revised plan reporting rules and issued regulations that enhance the means for monitoring fees paid to plan service providers. As explained by the DOL, “plan fiduciaries have a duty to consider a service provider’s compensation from all sources.”  The DOL’s initiatives in the area of fee disclosures include changes to Schedule C of the annual Form 5500 that have, since 2009, required the identification of persons providing investment management, recordkeeping, participant communication and other services to a plan if they received, directly or indirectly, $5,000 or more in reportable compensation. In addition, effective July 1, 2012, the Department’s regulations will require certain service providers to furnish fee disclosures prior to entering into or extending any service contract or arrangement. Plan sponsors, in turn, would be required to use such information to make disclosures to plan participants.The net result of these changes may be to shift onto plan sponsors the burden of detecting whether fee arrangements are burdened by conflicts of interest. |

|  |
| --- |
| * [Business Interruption 2nd Edition](http://www.nationalunderwriterpc.com/coverageguide/BusinessInterruption2ndEdition/Pages/default.aspx) * [Businessowners 5th Edition](http://www.nationalunderwriterpc.com/coverageguide/Businessowners5thEdition) * [Cancellation and Nonrenewal](http://www.nationalunderwriterpc.com/annual/CancellationNonrenewal/) * [CASE Approach to Financial Planning](http://pro.nuco.com/tandt/case) * [Closing The Gap](http://www.nationalunderwriterpc.com/coverageguide/closingthegap) * [Commercial Auto Program Coverage Guide](http://www.nationalunderwriterpc.com/coverageguide/CommercialAutoProgram) * [Commercial General Liability 10th Edition](http://www.nationalunderwriterpc.com/coverageguide/CommercialGeneralLiability10thEdition) * [CommercialProperty Guide 5thEdition](http://www.nationalunderwriterpc.com/coverageguide/CommercialProperty5thEdition) * [Condominium](http://www.nationalunderwriterpc.com/coverageguide/Condominium/Pages/default.aspx) * [Cyber Liability and Insurance](http://www.nationalunderwriterpc.com/cyberliability) * [Directors & Officers Liability Guide 2nd Edition](http://www.nationalunderwriterpc.com/coverageguide/DirectorsOfficersLiability2ndEdition) * [e-Coverage Guide](http://www.nationalunderwriterpc.com/coverageguide/ecoverage) * [Employment Practices Liability](http://www.nationalunderwriterpc.com/coverageguide/EmploymentPracticesLiability) * [ERISA Facts 2014](http://pro.nuco.com/taxfactsseries/2014erisa) * [ERISA Fiduciary Compliance Guide](http://pro.nuco.com/advisorsguide/ERISAFiduciaryCompliance) * [e-risk: Liabilities in a Wired World](http://www.nationalunderwriterpc.com/coverageguide/erisk) * [FC&S Premier](http://www.nationalunderwriterpc.com/sites/fcsonline/) * [FC&S Q&A Book](http://www.nationalunderwriterpc.com/book/fcsqabook) * [Field Guide to Estate Planning, Business Planning & Employee Benefits 2014](http://pro.nuco.com/fieldguide/estate2014/) * [Field Guide to Financial Planning 2014](http://pro.nuco.com/fieldguide/financial2014) * [Guide to Captives and Alternative Risk Financing](http://www.nationalunderwriterpc.com/coverageguide/CaptivesandAlternativeRiskFinancing) * [Healthcare Reform Facts 2014](http://pro.nuco.com/2014healthcarereformfacts) * [Home-Based Business](http://www.nationalunderwriterpc.com/coverageguide/HomeBasedBusiness) * [Homeowners 4th Edition](http://www.nationalunderwriterpc.com/coverageguide/Homeowners4thEdition/Pages/Default.aspx) * [Insurance Agency Sourcebook 2011](http://www.nationalunderwriterpc.com/annual/2011InsuranceAgencyMandA) * [Insuring to Value](http://www.nationalunderwriterpc.com/coverageguide/InsuringtoValue) * [Key Life Insurance Model Agreements](http://pro.nuco.com/kma) * [Licensing & Surplus Lines Laws](http://www.nationalunderwriterpc.com/annual/LicensingSurplusLinesLaws) * [Personal Auto 2nd Edition](http://www.nationalunderwriterpc.com/coverageguide/PersonalAuto2ndEdition/) * [Personal Lines Unlocked](http://www.nationalunderwriterpc.com/personallinesunlocked) * [Personal Umbrella](http://www.nationalunderwriterpc.com/coverageguide/PersonalUmbrella) * [Practical Risk Hedging](http://www.nationalunderwriterpc.com/practicalriskhedging) * [Problem Issues in CGL 2nd Edition](http://www.nationalunderwriterpc.com/coverageguide/ProblemIssuesinCGL2ndEdition) * [Process of Financial Planning](http://pro.nuco.com/tandt/process) * [Red Hot Introductions](http://www.nationalunderwriterpc.com/book/RedHotIntroductions) * [Risk Management for Financial Planners](http://pro.nuco.com/tandt/rmfinancial) * [Social Security & Medicare Facts 2014](http://pro.nuco.com/socialsecuritymedicare/2014SocialSecurityAndMedicareFacts) * [Target Markets: Auto Dealerships](http://www.nationalunderwriterpc.com/targetmarket/autodealer/) * [Target Markets: Contractors](http://www.nationalunderwriterpc.com/targetmarket/contractors) * [Target Markets: Restaurants](http://www.nationalunderwriterpc.com/targetmarket/restaurants) * [Target Markets: Truckers](http://www.nationalunderwriterpc.com/targetmarket/truckers) * [Tax Facts](http://pro.nuco.com/taxfacts2014/Pages/default.aspx) * [Tax Facts Intelligence](http://pro.nuco.com/taxfactsnews) * [Tax Facts on Individuals & Small Business 2014](http://pro.nuco.com/taxfactsseries/2014IndSmallBus) * [The Advisor’s Guide to 401(k) Plans](http://pro.nuco.com/advisorsguide/AdvisorsGuide401kPlans) * [The Advisor’s Guide to Annuities](http://pro.nuco.com/advisorsguide/AdvisorsGuideToAnnuities) * [The Advisor’s Guide to Group Life and AD&D](http://pro.nuco.com/advisorsguide/AdvisorsGuideToGroupLifeADD) * [The Advisor’s Guide to Nonqualified Deferred Compensation](http://pro.nuco.com/advisorsguide/AdvisorsGuideNonqualDefComp) * [The Advisor's Guide to Long-Term Care](http://pro.nuco.com/advisorsguide/AdvisorsGuideToLongTermCare) * [The Advisor's Guide to Qualified Plans](http://pro.nuco.com/advisorsguide/AdvisorsGuideToQualifiedPlans) * [The Consultative Brokerage](http://www.nationalunderwriterpc.com/book/TheConsultativeBrokerage) * [The Investment Advisor’s Guide to Compliance](http://pro.nuco.com/advisorsguide/InvestmentAdvisorsGuideToCompliance) * [The Wedge](http://www.nationalunderwriterpc.com/book/TheWedge) * [Time Management for Claims Professionals](http://www.nationalunderwriterpc.com/book/TimeManagementforClaimsProfessionals) * [Tools & Techniques of Principles of Estate Planning](http://pro.nuco.com/tandt/prinoestpla) * [Tools and Technique of Estate Planning for the Modern Families](http://pro.nuco.com/tandt/estate_modern) * [Tools and Techniques of Charitable Planning](http://pro.nuco.com/tandt/charity) * [Tools and Techniques of Employee Benefit and Retirement Planning 13th Edition](http://pro.nuco.com/tandt/employee13) * [Tools and Techniques of Estate Planning 16th Edition](http://pro.nuco.com/tandt/estate16) * [Tools and Techniques of Financial Planning](http://pro.nuco.com/tandt/financial/Pages/Default.aspx) * [Tools and Techniques of Income Tax Planning](http://pro.nuco.com/tandt/income) * [Tools and Techniques of Investment Planning, 3rd Edition](http://pro.nuco.com/tandt/investment3) * [Tools and Techniques of Life Insurance Planning 5th Edition](http://pro.nuco.com/tandt/lifeinsurance5ed) * [Tools and Techniques of Life Settlement Planning](http://pro.nuco.com/tandt/lifesettlement) * [Tools and Techniques of Retirement Income Planning](http://pro.nuco.com/tandt/retirementincome) * [Winning by the Rules](http://www.nationalunderwriterpc.com/book/WinningbytheRules) * [Workers Compensation Coverage Guide 2nd Edition](http://www.nationalunderwriterpc.com/coverageguide/WorkersCompensation2ndEdition) |

*Selecting and Monitoring Pension Consultants*

In carrying out their responsibility to prudently manage benefit plans for which they are responsible, fiduciaries often rely heavily on pension consultants and other professionals. However, questions have been raised concerning whether some pension consultants are fully disclosing potential conflicts of interest that may affect the objectivity of the advice they are providing to their benefit plan clients.

Under the Investment Advisers Act of 1940 (Advisers Act), an investment adviser providing consulting services has a fiduciary duty to provide disinterested advice and disclose any material conflicts of interest to its clients. In this context, SEC staff examined the practices of advisers that provide pension consulting services to plan sponsors and trustees. These consulting services included assistance in determining the plan’s investment objectives and restrictions, allocating plan assets, selecting money managers, choosing mutual fund options, tracking investment performance, and selecting other service providers. Many of the consultants also offered, directly or through an affiliate or subsidiary, products and services to money managers. Additionally, many of them offered, directly or through an affiliate or subsidiary, brokerage and money management services that were marketed to plans as a package of “bundled” services. The SEC examination staff concluded that the business alliances among pension consultants and money managers can give rise to serious potential conflicts of interest under the Advisers Act that need to be monitored and disclosed to plan fiduciaries.

To encourage the disclosure and review of more and better information about potential conflicts of interest, the Department of Labor and the SEC have developed the following set of questions to assist plan fiduciaries in evaluating the objectivity of the recommendations provided, or to be provided, by a pension consultant.

1.    Are you registered with the SEC or a state securities regulator as an investment adviser? If so, have you provided me with all the disclosures required under those laws (including Part II of Form ADV)?

**Note:** Plan sponsors and other plan fiduciaries can view Part I of the firm’s Form ADV by searching the SEC’s Investment Adviser Public Disclosure website. The investment adviser must furnish you with a copy of Part II of Form ADV.

At present, the IAPD database contains Forms ADV only for investment adviser firms that register electronically using the Investment Adviser Registration Depository. In the future, the database will expand to encompass all registered investment advisers – individuals as well as firms – in every state. If you can’t locate an investment adviser in IAPD, be sure to contact your state securities regulator or the SEC’s Public Reference Branch.

2.    Do you or a related company have relationships with money managers that you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, describe those relationships?

**Note:** When pension consultants have alliances or financial or other relationships with money managers or other service providers, the potential for material conflicts of interest increases, depending on the extent of the relationships. Knowing what relationships, if any, your pension consultant has with money managers may help you assess the objectivity of the advice the consultant provides.

3.    Do you or a related company receive any payments from money managers you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, what is the extent of these payments in relation to your other income (revenue)?

**Note:** Payments from money managers to pension consultants could create material conflicts of interest. You may wish to assess the extent of potential conflicts.

4.    Do you have any policies or procedures to address conflicts of interest or to prevent these payments or relationships from being considered when you provide advice to your clients?

**Note:** Probing how the consultant addresses these potential conflicts may help you determine whether the consultant is right for your plan.

5.    If you allow plans to pay your consulting fees using the plan’s brokerage commissions, do you monitor the amount of commissions paid and alert plans when consulting fees have been paid in full? If not, how can a plan make sure it does not over-pay its consulting fees?

**Note:** You may wish to avoid any payment arrangements that could cause the plan to pay more than it should in pension consultant fees.

6.    If you allow plans to pay your consulting fees using the plan’s brokerage commissions, what steps do you take to ensure that the plan receives best execution for its securities trades?

**Note:** Where and how brokerage orders are executed can impact the overall costs of the transaction, including the price the plan pays for the securities it purchases.

7.    Do you have any arrangements with broker-dealers under which you or a related company will benefit if money managers place trades for their clients with such broker-dealers?

**Note:** As noted above, you may wish to explore the consultant’s relationships with other service providers to weigh the extent of any potential conflicts of interest.

8.    If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment adviser to the plan while providing the consulting services we are seeking?

**Note:** All investment advisers (whether registered with the SEC or not) owe their advisory clients a fiduciary duty. Among other things, this means that advisers must disclose to their clients information about material conflicts of interest.

9.    Do you consider yourself a fiduciary under ERISA with respect to the recommendations you provide the plan?

**Note:** If the consultant is a fiduciary under ERISA and receives fees from third parties as a result of its recommendations, a prohibited transaction under ERISA occurs unless the fees are used for the benefit of the plan (*e.g*., offset against the consulting fees charged the plan) or there is a relevant statutory or class exemption permitting the receipt of such fees.

10.  What percentage of your plan clients utilizes money managers, investment funds, brokerage services or other service providers from whom you receive fees?