

**THE WAGNER LAW GROUP
A PROFESSIONAL CORPORATION**

**A Plan Sponsor's Fiduciary Duties Under ERISA:
With Great Responsibility Comes Great Potential Liability**
February 2010

Introduction

The Employee Retirement Income Security Act of 1974 ("ERISA"), which is the federal law regulating employee benefit plans, is a "two-faced" statute. On the one hand, there is absolutely nothing under ERISA that requires private employers to provide retirement plan benefits of any kind to its employees. However, once an employer voluntarily decides to establish a 401(k) plan, ERISA imposes all types of fiduciary duties on the employer, making it responsible for managing the plan's investment menu in accordance with a "prudent man standard of care." Along with this great fiduciary responsibility, ERISA heaps great potential liability on a 401(k) plan sponsor. Under ERISA's liability provisions, the employer can be held accountable for any investment losses suffered by plan participants as a result of the employer's failure to discharge its duties in accordance with the applicable standard of care.

ERISA Fiduciary Standards

Section 404 of ERISA imposes a prudent man standard of care on the employer and on other plan fiduciaries. This fiduciary standard is actually comprised of five separate standards.

- Duty of Loyalty. A fiduciary must discharge his duties solely in the interest of plan participants. Thus, the fiduciary must avoid conflicts of interest when managing plan assets.
- Exclusive Purpose Rule. A fiduciary must discharge his duties for the exclusive purpose of providing benefits or defraying reasonable expenses only. The plan must not pay excessive compensation to its investment and service providers.
- Duty of Care. A fiduciary must discharge his duties with the "care, skill, prudence and diligence under the circumstances then prevailing that a prudent man 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." This standard of care is also known as the "prudent expert" standard.
- Duty to Diversify. A fiduciary must diversify the plan's investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.
- Duty of Obedience. A fiduciary must discharge his duties in accordance with the documents and instruments governing the plan insofar as they are consistent with ERISA.

In the context of a 401(k) plan, the employer generally must make its fiduciary decisions concerning the plan's investment menu solely in the interest of plan participants (Duty of Loyalty). It must also identify the various types of fees payable to the plan's investment and

THE WAGNER LAW GROUP
A PROFESSIONAL CORPORATION

service providers, and determine that they are reasonable in light of the investments and services provided (Exclusive Purpose Rule). The plan sponsor should also prudently select the funds for the plan's menu and review their performance on an ongoing basis (Duty of Care), while ensuring that the overall menu includes a broad range of investment choices (Duty to Diversify). To help itself meet these requirements, the plan sponsor should consider establishing a written investment policy statement and following the policy's stated guidelines in connection with its ongoing review of the plan menu (Duty of Obedience).

Given the procedural nature of these requirements, a 401(k) plan sponsor can achieve compliance with ERISA's fiduciary standards by adopting and maintaining a prudent investment review process. Plan fiduciaries are typically judged by how they arrive at their investment decisions with the information then available to them. A fiduciary breach does not occur merely because in hindsight they could have achieved superior investment results. A qualified financial advisor can help plan sponsors develop and follow prudent review procedures for their plan investments. An employer should also strongly consider taking advantage of its financial advisor's substantive investment expertise and knowledge of the 401(k) plan market.

Enforcement and Fiduciary Liability Under ERISA

Although ERISA does not require plan sponsors to insulate participants from all investment losses in all situations, it does make employers responsible for losses that result from their mistakes. Under ERISA Section 409, any person who is a plan fiduciary is personally liable for any losses that result from a breach of his duties under ERISA. In its 2008 decision, *LaRue v. DeWolff, Boberg & Associates*, the U.S. Supreme Court confirmed that an individual participant (in addition to the U. S. Department of Labor ("DOL") or a co-fiduciary) may bring a civil action to enforce this ERISA liability provision. Alternatively, a participant who does not wish to incur the expense of litigation can simply call the Office of Participant Assistance within the DOL's Employee Benefit Security Administration ("EBSA"). Participant complaints with merit are routinely investigated by EBSA and may lead to referrals to its enforcement division.

A tremendous amount of regulatory scrutiny and litigation activity has arisen with respect to 401(k) plan service fees, especially with respect to any "hidden" or indirect compensation payable from the plan's investments (or investment providers) to its service providers. As part of its regulatory initiative to improve fee transparency, the DOL now requires enhanced fee disclosures on the Form 5500 annual return for plans, beginning with the plan year for 2009. The DOL is expected to finalize its other regulations concerning fee transparency shortly. Furthermore, a mounting number of class action lawsuits have been filed against some of the nation's largest employers, alleging that they breached their fiduciary duties by approving excessive 401(k) plan fees. Such actions typically claim that the plan sponsor failed to monitor the indirect compensation payable to the plan's service providers.

Fortunately, it is not difficult for 401(k) plan sponsors to shield and protect themselves from any such scrutiny. With modest amounts of planning and timely assistance from their financial advisors, plan sponsors can readily ensure their investment funds have been selected with prudence, that plan fees are reasonable in light of the investments and services provided,

**THE WAGNER LAW GROUP
A PROFESSIONAL CORPORATION**

and that their investment menus are being maintained and reviewed in accordance with the fiduciary standards of ERISA.