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New DOL regulations raise the bar for plan fiduciaries

By Richard F. Stolz

The job of being a retirement plan fiduciary may soon be a more lonely experience. Or at least it might just seem that way, thanks to last month's effective date on the Labor Department's 408(b)(2) regulations, which officially kicked in on July 16. In either case, plan sponsors have an even greater incentive to review their fiduciary status and rededicate themselves to the task of fulfilling their obligations as fiduciaries.

Although the thrust of those regulations deals with fee disclosure by plan providers – a topic that has received considerable attention since they were proposed, 408(b)(2) also requires companies providing services to retirement plans to disclose their "status" in relationship to the plan. That is, they must explicitly state that they are acting in a fiduciary capacity – but only if indeed that is what they are doing.

"On the other hand, if they are not [acting as a fiduciary], there is no requirement that they make that negative statement," notes veteran ERISA attorney Fred Reish, a partner with Drinker Biddle in Los Angeles.

Reish believes many plan sponsors will be surprised to learn through this process that individuals or entities they had been relying on for advice about their plans – particularly regarding the selection of investments – are not, in fact, fiduciaries.

Believing that multiple fiduciaries are watching out for the best interests of a plan and its participants can give comfort to plan sponsors, just as a lack of outside fiduciaries may create a worrisome concentration of fiduciary duty on the employer's shoulders.

Wink and a nod

Marsha Wagner, an ERISA attorney with the Wagner Law Group in Boston, says that many retirement plan advisors have up until now been able to finesse the question of their fiduciary status "with a wink and a nod." That is no longer the case.

The upshot of 408(b)(2) for plan sponsors who find themselves with fewer fiduciaries looking out for the best interests of the plan is an even more acute need to "become more discerning consumers" of services provided to the plan, according to Wagner.

Plan service providers generally must furnish data required by the 408(b)(2) regulations by the end of this year. The regulations are kicking in against a backdrop of a surge in litigation against plan sponsors for a myriad of alleged fiduciary breaches, Wagner says. “Frankly, I’ve never seen so much litigation going on in the ERISA area.”

That suggests it’s a good time for plan sponsors to review not only what their fiduciary obligations are, but who indeed is a fiduciary – particularly when the moment of truth is at hand with respect to plan vendors. Fred Reish addresses the eternal “who-is-a-fiduciary” question this way: While noting that an individual within the plan sponsor organization can be given the official designation as plan fiduciary, the ultimate test of fiduciary status “is functional.”

Although the fiduciary status determination has been made “a little murky” by conflicting court determinations in fiduciary breach cases over the years, “as a general rule, the Department of Labor takes the position that the decision-maker is the fiduciary,” Reish says.

The number of *de facto* in-house fiduciaries will vary from one plan sponsor to the next, depending, for example, on the existence of committees whose members are specifically given responsibility for running the plan.

Also, even a mid-level employee benefit manager not serving on such a committee, but given some responsibility for plan operations, would likely be deemed a fiduciary as well, according to Frank Palmieri, an *EBN* legal columnist and ERISA attorney with Palmieri & Eisenberg, a firm with offices in Princeton N.J. and Alexandria, Va.

Fiduciaries’ obligations

The basic obligations of fiduciaries are the same, whether they are employed by the plan sponsor or providing advice to the plan. That duty, Reish says, is to safeguard the best interests of the plan and its participants applying standards of a “prudent man.” This is known as the “prudent man rule.”

Individuals providing advice to a retirement plan whose compensation is impacted by their recommendations are assumed to have a conflict of interest, and cannot be considered a fiduciary. When the advice concerns plan investments, such advisors are only expected to make recommendations based on a lower “suitability” standard. Under that standard, investments only need to be considered suitable, as a general matter, for investors with similar broad objectives.

Some broker-dealers advising companies on 401(k) investments who are worried about losing 401(k) clients by virtue of not being a fiduciary may soon modify their compensation practices, according to Reish. That would require that the advisor “levelize” his compensation – be paid a fixed fee, regardless of which investments are selected by the plan.

Reish notes that, in theory, a plan fiduciary could be guilty of breech of fiduciary obligations by accepting poor recommendations for plan investments from an investment broker held to the lower “suitability” standard, even while the broker might not have any liability for his recommendations.

“Procedural prudence”

A key principle governing how a court would assess a fiduciary’s fulfillment of his fiduciary obligations, Palmieri says, is whether he exercised “procedural prudence."

"Your decision in hindsight isn't looked at as to whether it's a good or bad decision," he says. "It's looked at as to whether it was a prudent decision when you made it for valid reasons."

In making that determination, says Wagner, courts will assign a lot of weight to "having good documentation, processes and procedures in place."

With the Labor Department's 408(b)(2) regulations beginning to kick in, the focus of that documentation for fiduciaries will particularly acute around the issue of vendor selection. Fiduciaries "have a duty to prudently review and evaluate all the information they're going to be getting under 408(b)(2)," Reish says. "They'll have to look at the services and ask, 'are these the services we thought we were getting? And do we think the compensation is reasonable?"

If 408(b)(2) disclosures reveal that a particular service provider is not acting in a fiduciary capacity, the plan sponsor will need to assess whether the needs of the plan would be better served if that service provider were indeed acting in a fiduciary capacity, Reish says. However, "if the providers aren't fiduciaries, there's no requirement that the plan sponsors to do anything" to change the situation, he adds.

For most plan fiduciaries employed by the plan sponsor, the most concrete implication of the 408(b)(2) regulations is the need to do a fresh reality check on the quality and cost competitiveness of their plan service providers. "I think you're going to see a lot more RFPs and a lot more benchmarking for administrative and investment services," predicts Wagner.

And, consistent the courts' emphasis on the importance of "procedural prudence," Wagner expects to see "an evolving best practices trend whereby sponsors document more of their decisions and their rationale for their decisions."

That will include plan sponsors increasingly "dusting off their old investment policy statements and updating and upgrading them," she adds.

RFPs conducted by attorneys

Frank Palmieri has already seen evidence of this trend. He says he has taken on assignments to conduct vendor searches for retirement plans. "They come to us because it's a fiduciary decision," he says. "They want to be guided through it so that at the end of the day they an document that they have done a proper search, thereby minimizing their liability."

Wagner says she has also experienced an increase in the demand for such services.

Since plan fiduciaries are personally liable for their actions, the importance of documenting those efforts may be critical even when the company winds up not carrying out a given activity. Palmieri recalls an experience involving a plan sponsor whose CEO was a childhood friend of the broker representing its principal 401(k) vendor. The CEO refused to put the plan out for bid even told that the vendor's fees were not competitive.

The executive with hands-on responsibility for the 401(k) might have done well to document that he had "raised the concern and made recommendations," Palmieri says.

Another potentially treacherous situation for fiduciaries involves accepting gifts from service providers. Some plan vendors, Palmieri observes, invite clients to attend complimentary educational seminars. While that might be innocent enough, if too many freebies are added in – for example, the hotel room and a round of golf – fiduciaries might be determined to have lost their capacity for objectively assessing the vendor's performance with regard to plan services.

Given the fiduciary liability case law's emphasis on "procedural prudence," Palmieri suggests employers adapt a corporate gift policy for plan fiduciaries.

During a time of rising ERISA litigation, that need for documentation also applies to the most routine decisions about retirement plan design, according to Wagner. Those decisions include the level of investment education for plan participants, whether to offer a managed account option, and whether active or passive mutual funds are better for participants.

"The fiduciary standards are evolving," she says. "The more issues that are brought to the fore, the greater the need for documentation, good processes and procedures."

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