

## ERISA Fiduciary Duty and the Duty to Monitor

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If you are an employee or member of the board of directors of a company that sponsors a tax-qualified retirement plan, such as a 401(k) plan, you may be a fiduciary under the Employee Retirement Income Security Act of 1974, as amended (ERISA). This article will identify who is an ERISA fiduciary, describe the ERISA fiduciary duties, summarize the potential liabilities of ERISA fiduciaries, and outline a series of steps that an ERISA fiduciary can take to limit his or her liability by fulfilling his or her duty to monitor under the retirement plan. This article is not intended to provide a comprehensive review of fiduciary duties under ERISA, and board members and employees with ERISA fiduciary duties who are unfamiliar with the full scope of their duties are advised to consult ERISA counsel.

### *Who is a Fiduciary?*

A fiduciary under ERISA is defined as a person who (i) exercises discretionary authority or discretionary control with respect to the management of a retirement plan or exercises any authority or control with respect to the disposition of plan assets, (ii) renders investment advice for a fee with respect to the money or other property of the retirement plan, or (iii) has any discretionary authority or discretionary responsibility in the administration of the retirement plan.<sup>2</sup>

The administrator of a retirement plan is the person or committee identified in the plan document, or if none is identified, then the administrator is the "plan sponsor".<sup>3</sup> The "plan sponsor" of a retirement plan is the employer that sponsors the plan.<sup>4</sup> As the ultimate representative of the employer, the board of directors, therefore, assumes the role of plan administrator unless the board or the plan document affirmatively delegates that responsibility. Typically a board or plan document may delegate such responsibility to a member of the employer's management team or to an administrative committee made up management and key employees of the employer, in which case the manager or administrative committee assumes the role of plan administrator and becomes an ERISA fiduciary. Other ERISA fiduciaries include the plan trustee and plan investment manager (if

any); however, the focus of this article is on the board of directors as a fiduciary and the manager or administrative committee to whom administration of the retirement plan is delegated.<sup>5</sup>

### *ERISA Fiduciary Duties*

An ERISA fiduciary is required to discharge his or her duties with respect to the retirement plan solely in the interest of the plan participants and their beneficiaries.<sup>6</sup> Furthermore, a fiduciary, including the plan administrator (the board member or the manager or committee member appointed by the board), is required discharge his or her duties:

- for the exclusive purpose of providing benefits to plan participants and their beneficiaries and defraying reasonable expenses of administering the retirement plan;
- with the care, skill, prudence, and diligence that, under the then current circumstances, a prudent person acting in a similar capacity and who is familiar with such matters would use in the conduct of an enterprise with like character and like aims;
- by diversifying investments of the retirement plan to minimize the risk of large losses (unless under the circumstances it is clearly not prudent to do so); and
- in accordance with the retirement plan documents, provided that the documents are in compliance with ERISA.<sup>7</sup>

It is important to note that ERISA fiduciaries are not required to be right with respect to every decision made in connection with the administration of the retirement plan.<sup>8</sup> Instead, the focus is on how the fiduciary acted and what processes the fiduciary followed in making its decisions. Specifically, did the fiduciary act for the benefit of the plan participants and their beneficiaries; did the fiduciary act prudently given the circumstances at the time; did the fiduciary act to provide a diversified portfolio in the retirement plan; and did the fiduciary act in accordance with the terms of the plan documents.

### *ERISA Liability*

An ERISA fiduciary who fails to meet his or her responsibilities under ERISA may be held personally liable.<sup>9</sup> If the retirement plan incurs losses as a result of the fiduciary's breach of fiduciary duty, the ERISA fiduciary may be required to restore those losses to the retirement plan or to restore profits made by the fiduciary using plan assets.<sup>10</sup> In addition, an ERISA fiduciary who participates in, conceals, or does not act to correct the breach of a co-fiduciary, may be held liable for the co-fiduciary's breach under the doctrine of co-fiduciary liability.<sup>11</sup>

## *The Duty to Monitor*

While ERISA does not expressly state a "duty to monitor", courts have recognized a duty to monitor and many of the fiduciary duties outlined above may be fully or partially fulfilled through a regular monitoring process.<sup>12</sup>

### *Monitoring by the Board of Directors*

If the board of directors at your company has not already done so, it should consider delegating the role of plan administrator to a member of the management team or preferably to a committee of managers and key employees of the company. Frequently, an administrative committee may include a representative from the company's finance department and human resources department, along with other executives or managers. The committee should consist of an odd number of members and should have enough members that the committee is able to meet quarterly with a quorum.

Once the board has delegated such authority and responsibility to an administrative committee, the board should monitor the committee to determine whether the committee is meeting its fiduciary duties with respect to the retirement plan.<sup>13</sup> For example, the board may require that the administrative committee prepare an annual report for the board's review. If the board of directors elects not to delegate the administration of the retirement plan to an administrative committee, the board should consider following the steps outlined below for the administrative committee.

Typically, the board of directors also will have the authority to appoint the retirement plan trustee. In most circumstances the plan trustee will be a directed trustee with very limited duties and fiduciary obligations. In any event, the board of directors should also monitor the plan trustee on a regular basis to confirm that the plan trustee is meeting its fiduciary duties and not otherwise acting improperly.<sup>14</sup> The board may choose to delegate responsibility for monitoring the plan trustee to the administrative committee, in which case the administrative committee may include a report on the performance of the plan trustee in its annual report to the board.

### *Monitoring by the Administrative Committee*

After the board of directors has appointed the administrative committee and delegated to the committee the discretionary authority and discretionary responsibility to administer the

retirement plan, the committee should take the following steps in connection with fulfilling its duty to monitor.

### *1. Adopt an Administrative Committee Charter*

Every administrative committee should have a written charter that, among other things, sets forth the committee's duties and responsibilities. The charter also may set forth the schedule and procedures the administrative committee will follow in fulfilling those duties and responsibilities. For example, the charter may provide that the administrative committee will meet at least four times per year; that the committee will monitor the performance of the retirement plan service providers on at least an annual basis by meeting with service provider representatives or reviewing the adequacy of services performed during year; and that the committee will report annually to the company's board of directors.

### *2. Hire Experts*

In fulfilling its ERISA fiduciary duty to act prudently, the administrative committee, in almost all cases, will want to hire a team of experts to assist in the administration of the retirement plan.<sup>15</sup> These expert third party service providers usually include, at least, a record keeper and investment adviser. However, there may be other third party service providers who are not as readily apparent. For example, some retirement plans use third party service providers to provide limited investment advice to plan participants and their beneficiaries. On a regular basis and as set forth in the administrative committee charter, the committee should monitor the performance of the service providers. The United States Department of Labor suggests: (1) reviewing the service provider's performance, (2) reading any reports provided by the service provider, (3) understanding and confirming all fees actually charged to the retirement plan or to the employer by the service provider, (4) asking the service provider for a full explanation of the service provider's policies, practices and internal controls, and (5) following up on any plan participant complaints regarding the service provider.<sup>16</sup>

In addition to the experts hired by the administrative committee, the committee should recognize the employees within the company who provide services to the retirement plan. Staff in the human resources department, the benefits department and even the finance department may be performing services for the employer related to the retirement plan. The administrative committee may elect to delegate responsibility for monitoring staff

performance to the managers of the departments in which the staff members work; however, the committee should confirm that such monitoring is taking place and the committee should be made aware of any serious performance issues, just as the administrative committee would be made aware of serious performance issues of third party service providers and in a manner consistent with the administrative committee charter.

### *3. Monitor Investment Performance*

In addition to the adoption of an administrative committee charter, the committee should consider adopting an investment policy. A well-drafted investment policy will provide guidance to the administrative committee with respect to establishing a diversified portfolio and will assist the administrative committee in monitoring the performance of the investment options in which the retirement plan assets are invested. For example, the investment policy may identify the benchmarks against which the returns of plan investments should be compared. By identifying such benchmarks, the administrative committee can monitor the performance of the plan investments against the applicable benchmarks and identify underperforming investments. The administrative committee's investment advisor also can assist the committee in monitoring plan investments by providing performance reports on the plan investments. The administrative committee should consider reviewing the performance of the plan investments on a quarterly basis.

The duty to monitor investment performance is applicable even with respect to retirement plans that rely on the so-called "404(c) safe harbor" to insulate plan fiduciaries from liability to plan participants for losses sustained in the participants' individual accounts based on investment losses stemming from participant-directed investments. The administrative committee is responsible for selecting the investment options offered, monitoring the performance of the investment options and replacing investment options with new ones if the committee uncovers problems with the existing investment options (e.g., underperformance after change of portfolio managers, government investigations of wrongdoing, etc.), even if the plan participants are responsible for making the actual investment decisions related to their individual accounts in accordance with the safe harbor.<sup>17</sup>

### *4. Keep Written Records*

One of the most important tasks for the administrative committee is documenting the committee's actions, usually through the written minutes of the administrative committee quarterly meetings.<sup>18</sup> The ERISA duty of prudence is directly connected to the

administrative committee's process for making decisions in its fiduciary capacity. Thus, documenting the decision-making process is an integral part of the administrative committee function. The administrative committee minutes should record, among other things, that the committee is regularly monitoring the plan service providers and the performance of the plan investments in accordance with the terms of the administrative committee charter or investment policy. The minutes of the administrative committee should be kept in a separate file and should be retained in accordance with the company's ERISA document retention policy.

### *Conclusion*

Monitoring the performance of the retirement plan, the plan service providers and the plan investments is not the only fiduciary duty imposed on the board of directors or the administrative committee by ERISA; however, such monitoring will go a long way in assisting the board and administrative committee in meeting their fiduciary obligations to the plan participants and their beneficiaries. Consistent monitoring of a retirement plan reflects the prudence of the ERISA fiduciary in meeting his or her ERISA fiduciary duties. In addition, consistent monitoring may allow the fiduciary to identify an issue in the administration of the retirement plan, before the plan participants and their beneficiaries suffer a loss. Thus, consistent monitoring can reduce the ERISA fiduciary's personal liability to the retirement plan participants.

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<sup>2</sup> ERISA § 3(21), 29 U.S.C. § 1002(21).

<sup>3</sup> ERISA § 3(16)(A), 29 U.S.C. § 1002(16)(A).

<sup>4</sup> ERISA § 3(16)(B), 29 U.S.C. § 1002(16)(B).

<sup>5</sup> See ERISA §§ 3(38) and 405(c), 29 U.S.C. §§ 1002(38) and 1105(c).

<sup>6</sup> ERISA § 404(a), 29 U.S.C. § 1104(a).

<sup>7</sup> *Id.*

<sup>8</sup> *Donovan v. Mazzola*, 716 F.2d 1126, 1232 (9th Cir. 1983), *cert. denied*, 464 U.S. 1040 (1984).

<sup>9</sup> ERISA § 409, 29 U.S.C. § 1109.

<sup>10</sup> *Id.*

- <sup>11</sup> ERISA § 405, 29 U.S.C. § 1105.
- <sup>12</sup> See *Lingis v. Motorola, Inc.*, No. 03-CV-5044, 2009 BL 129857 (N.D. Ill. June 17, 2009).
- <sup>13</sup> See 29 C.F.R. § 2509.75-8, *Questions and answers relating to fiduciary responsibility under the Employee Retirement Income Security Act of 1974*.
- <sup>14</sup> *Id.*
- <sup>15</sup> See United States Department of Labor, elaws - ERISA Fiduciary Advisor, *What are fiduciary responsibilities?*, <http://www.dol.gov/elaws/ebsa/fiduciary/q4b.htm>.
- <sup>16</sup> United States Department of Labor, elaws - ERISA Fiduciary Advisor, *Is hiring a service provider a fiduciary function, and if so, what do I need to do?*, <http://www.dol.gov/elaws/ebsa/fiduciary/q4f.htm>.
- <sup>17</sup> See ERISA §§ 404(a)(1)(C) and 404(c), 29 U.S.C. §§ 1104(a)(1)(C) and 1104(c). See also United States Department of Labor, elaws - ERISA Fiduciary Advisor, *What are my liabilities as a fiduciary and how can I limit them?*, <http://www.dol.gov/elaws/ebsa/fiduciary/q4c.htm>.
- <sup>18</sup> United States Department of Labor, elaws - ERISA Fiduciary Advisor, *What are fiduciary responsibilities?*, <http://www.dol.gov/elaws/ebsa/fiduciary/q4b.htm>.