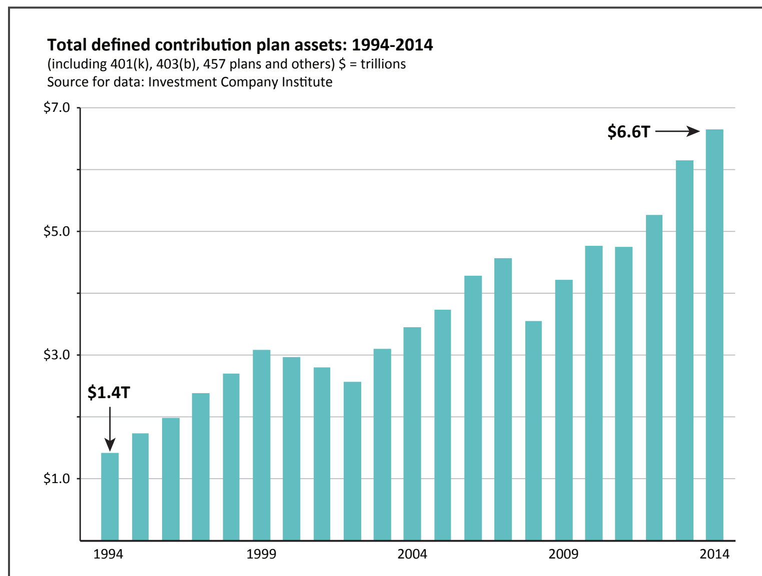
Safe Harbor
PARTNERS

ERISA & Fiduciaries: Know the Code

Over the last 20 years, the defined contribution retirement plan market has grown rapidly, rising from $1.4 trillion in 1994 to more than $6.6 trillion in 2014.[1] The number of retirement plans and active participants has increased along with the assets; as of 2013 (the most current data available from the U.S. Department of Labor), there were over 527,000 401(k) plans with a total of more than 64 million active participants.[2]



As the level of assets, plans and participants in the retirement plan market have grown, so too have the number of companies offering products and services in the marketplace. The sheer amount of money in the retirement plan market makes it appealing to a wide range of companies offering services and solutions. Moreover, the complexity of the industry, regulations, and investment markets creates opportunities for vendors. Many firms serving the retirement plan market offer solutions that promise to make it easier, less stressful and less costly for employers to offer retirement planning benefits.

One of the biggest requirements plan sponsors have comes in meeting their responsibilities as fiduciaries to their retirement plan. The Department of Labor (DOL) states that fiduciaries have important responsibilities and are subject to standards of conduct because they act on behalf of participants in a retirement plan and their beneficiaries. The responsibilities as spelled out by the DOL include:

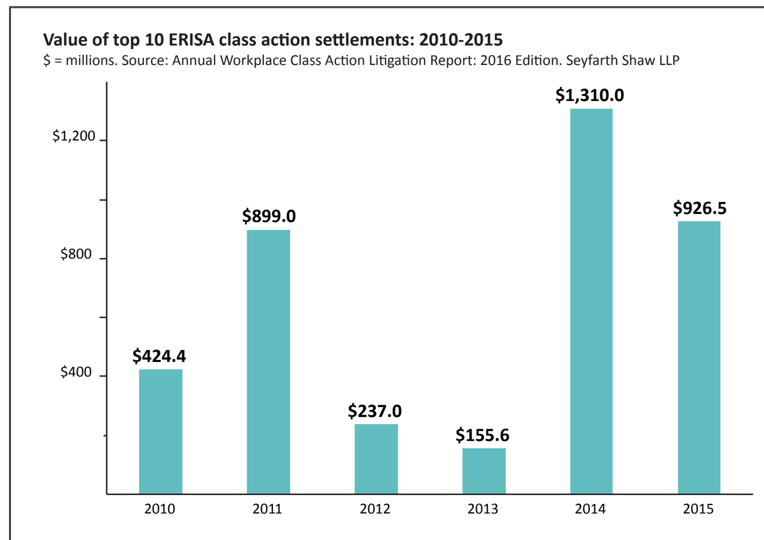
- Acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them;
- Carrying out their duties prudently;
- Following the plan documents (unless inconsistent with ERISA);
- Diversifying plan investments; and
- Paying only reasonable plan expenses

Front cover photo by Steve Heap/Shutterstock.

[1] "The U.S. Retirement Market", Investment Company Institute, 3rd Quarter 2015

[2] "Private Pension Plan Bulletin", U.S. Department of Labor, Employee Benefits Security Administration, September 2015.

As that last point indicates, plan fiduciaries are legally obligated to ensure the options available on their plan's investment menu and the service providers hired by the plan do not charge excessive fees to plan participants. In recent years, plan sponsors have faced a flood of class action lawsuits, most of them related to excessive fees for investment options and services and breach of fiduciary duty for failing to monitor these fees or offer lower-cost alternatives. (See chart below.)



In response to the threat of potential lawsuits and personal liability for breach of fiduciary duty, service providers and vendors in the retirement plan marketplace have introduced fiduciary support solutions that offer to shield plan sponsors from liability. These solutions are often marketed in ways that convey a sense of protection (e.g.,"warranty" or "guarantee"). Plan sponsors may believe they are getting "protection" from liability or support in meeting their fiduciary obligations. In reality, there is little support or protection.

The Devil in the Details

The fine print behind these protective solutions shed light on the limits of fiduciary support. For example, some of these fiduciary warranties state that the investments offered on the service provider's platform will be the lowest net investment cost available. Many plan sponsors may find this level of protection appealing, given the prevalence of litigation around excessive fees among the investment options available in many plan lineups.

However, the agreements are often limited only to the funds available on the service provider's menu or to a select list of investment options. Other share classes often with significantly lower fees exist, but they are not provided as an option to the plan sponsor because doing so would not be not consistent with the business and profit model of the service provider. Therefore, these less expensive options fall outside of the scope of the low-cost guarantee. A thorough RFP conducted by the plan sponsor would have uncovered the share class expense issue and corresponding flaws of the fiduciary warranty.

These limitations are often only found in the fine print of marketing materials that promote these agreements. Plan sponsors have the responsibility as part of their fiduciary duties to read and understand these agreements and understand the provisions before they are introduced into a plan. The limited scope of these agreements may not offer much protection to plan fiduciaries when they are faced with class action lawsuits.

Rely on the Facts

With all of the confusion in the marketplace, we recommend that plan sponsors know and follow the letter of the law to meet their fiduciary obligations as defined in current ERISA law. Plan sponsors should take compliance responsibilities regarding these regulations into their own hands, rather than rely on third-party vendors to offer fiduciary "protections" that are limited in scope and not likely to hold up to scrutiny in a court of law.

Let's look at some relevant sections from the ERISA code related to fiduciary duty, to provide plan sponsors with a clear understanding of what it takes to carry out their fiduciary duties and comply with existing ERISA law.

[ERISA Section 406, 29 USC 1106 – Prohibited transactions]

(a) Transactions between plan and party in interest - Except as provided in section 1108 of this title:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect -

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107 (a) of this title.

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 1107 (a) of this title.

These provisions establish what is prohibited by a plan fiduciary. For example, if as a fiduciary you allow a service provider to receive more compensation than they have actually earned, you have engaged in a "prohibited transaction".

[ERISA Section 408, 29 USC 1108 – Exemptions from prohibited transactions]

(a) Grant of exemptions - The Secretary may not grant an exemption under this subsection unless he finds that such exemption is—

(1) administratively feasible,

(2) in the interests of the plan and of its participants and beneficiaries, and

(3) protective of the rights of participants and beneficiaries of such plan.

Exemptions to the prohibited transactions allow fiduciaries to hire service providers

(c) Fiduciary benefits and compensation not prohibited by section 1106 - Nothing in section 1106 of this title shall be construed to prohibit any fiduciary from—

(1) receiving any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;

(2) receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan; except that no person so serving who already receives full time pay from an employer or an association of employers, whose employees are participants in the plan, or from an employee organization whose members are participants in such plan shall receive compensation from such plan, except for reimbursement of expenses properly and actually incurred; or

(3) serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest.

Fiduciaries can pay service providers reasonable compensation, as long the costs are properly and actually incurred in the performance of their services. However, many plan sponsors are not ensuring fees paid to their service providers are reasonable.

Fiduciaries shall be personally liable for losses and to restore profits if found to have breached any of their fiduciary responsibilities.

[ERISA Section 409, 29 USC 1109 – Liability for breach of fiduciary duty]

(a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter **shall be personally liable** to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 1111 of this title

(b) No fiduciary shall be liable with respect to a breach of fiduciary duty under this subchapter if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary.

This provision establishes the right of plan participants and beneficiaries to bring civil action.

ERISA Section 502, 29 USC 1132 – Persons empowered to bring civil action

(a) A civil action may be brought—

(1) by a participant or beneficiary—

(A) for the relief provided for in subsection (c) of this section, or

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title;

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan;

(4) by the Secretary, or by a participant, or beneficiary for appropriate relief in the case of a violation of 1025(c) of this title;

Plan Sponsor Next Steps

With a wide array of players and service providers in the retirement plan marketplace, it falls on plan sponsors to understand who they are hiring when they bring a vendor in to service their plan. Plan sponsors should ask two important questions:

Are you a fiduciary?

This is a fair question with the focus the Department of Labor is giving to fiduciary duties and working in the interests of plan participants. Both plan sponsors and participants are often well served when product providers and vendors act as a fiduciary.

How do you get paid?

This is a critical question. When vendors are paid out of investment fees, there is a possibility that plan participants will not have access to the investment options with the lowest-cost share classes. The potential for conflicts of interest also increases and lines defining the best interests of participants become blurred.

The checklist below can help plan sponsors gather and review responses for any vendors being considered for their retirement plan. Contracts or agreements presented by vendors should be reviewed for provisions related to fiduciary standards, fees or compensation paid to third-party providers or intermediaries.

- What fiduciary responsibility does your organization assume? Indicate what services are to be provided as a fiduciary or registered investment adviser. Will you act as either a 3(21) or 3(38) advisor to the plan?
- Describe any pending litigation, or litigation within the last 5 years, relating to the services you are proposing.
- Do you provide an open architecture platform?
- Are all mutual funds and ETFs available through the platform? If not, describe limitations.
- Please identify the steps taken to insure that the lowest cost share class is available and implemented.
- Disclose any conflicts of interest that your firm may have in providing service for our plan.
- Do you receive any 12b-1 or other compensation from any mutual funds that are or will be contained in the plan and, if so, is it used to reduce costs?
- Will your firm, its employees, and/or any affiliated or related entity be paid fees and/or commissions (including those from revenue-sharing and commission recapture) for its services to the plan from sources other than the plan?
- Does your firm, its employees, and/or any affiliated or related entity derive any economic benefit from any investment entities, intermediaries or service providers that are or will be involved in our plan?

Safe Harbor
PARTNERS

6723 WHITTIER AVENUE, SUITE 200 | MCLEAN, VA 22101 | P. 703-752-6007 | F. 703.752-6015