Plan Sponsor
Digest

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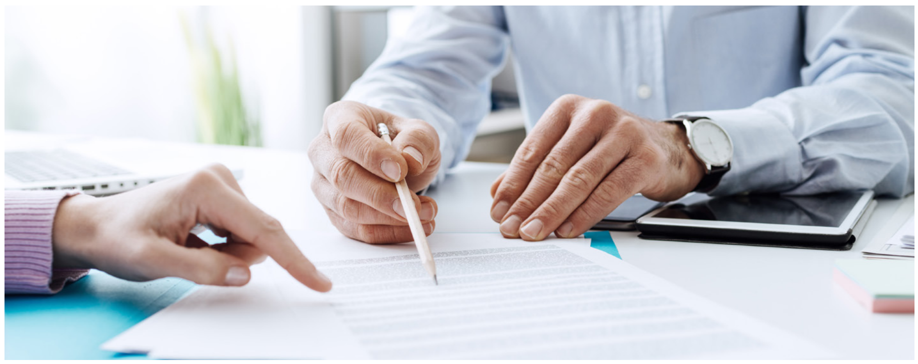
Understanding What It Means To Be a Plan Fiduciary

Many activities involved in operating a qualified retirement plan may make the person or entity performing those activities a plan fiduciary. As a plan sponsor, it's important for you and other fiduciaries of your plan to fully understand your responsibilities and the consequences of not fulfilling them.



Who is a fiduciary?

With limited exceptions, under ERISA, a fiduciary is anyone who: exercises any discretionary authority or discretionary control over the management of the plan; exercises any authority or control with respect to management or disposition of the plan's assets; has any discretionary authority or discretionary responsibility over the administration of the plan; gives investment advice to the plan for a fee or other direct or indirect compensation or has the authority or responsibility to do so. Thus, fiduciaries may include, but aren't limited to, the plan's trustee, investment manager, administrator, administrative committee, and the plan sponsor.

What are a fiduciary's duties?

A plan fiduciary must follow the plan documents (unless they're inconsistent with ERISA) and act solely in the interests of the plan participants and their beneficiaries and for the exclusive purpose of providing benefits to them. In addition, a plan fiduciary must act with the care, skill, prudence, and diligence that a prudent person would exercise under similar circumstances. Fiduciaries must also make sure the plan's investments are diversified (unless it's clearly prudent not to do so under the circumstances) and pay only reasonable plan expenses.

Does the pension law prohibit any specific actions?

Yes, ERISA prohibits certain types of transactions between the plan and specified related parties (called "parties in interest"). As employer/plan sponsor/fiduciary, you are considered a party in interest to the plan. Other parties in interest include employees of the plan, any other fiduciaries (such as the plan's administrator, officer, trustee, or custodian) the plan's counsel, plan service providers, a direct or indirect owner of 50% or more of the sponsoring company, and relatives (as defined under ERISA) of 50%-plus owners.

What transactions are prohibited?

Examples of prohibited transactions between the plan and a party in interest include selling, exchanging, or leasing property; lending money or extending credit; and furnishing goods, services,

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or facilities. The law contains exceptions that protect the plan in conducting necessary transactions that would otherwise be prohibited and for many dealings with financial institutions that are essential for the plan's ongoing operations. For example, a plan can hire a service provider, as long as the services are necessary to operate the plan and the contract or arrangement with the provider and the compensation paid for the services are reasonable. And plans may offer loans to participants as long as certain requirements are met.

Are there any other prohibitions?

Fiduciaries also are prohibited from self-dealing. Various restrictions prevent a fiduciary from deriving personal gain from actions that involve the plan. Because of the complexity of the prohibited transaction rules, you should consult your plan's ERISA attorney for advice before engaging in transactions involving plan assets.

What happens if a plan sponsor breaches its fiduciary duty?

Fiduciaries that breach their responsibilities may be personally liable to restore the plan to the condition it was in prior to the breach, including restoring any monetary losses and returning any profits made through the use of plan assets. A fiduciary also may be subject to excise taxes for violating the prohibited transaction rules.

Why Have a Written Investment Policy Statement?

SITUATION: We have a 401(k) plan that allows our employees to direct the investment of their own plan account assets. We comply with all of the pension law's Section 404(c) requirements so that our liability for investment decisions made by participants is limited. However, we don't have a written investment policy statement. A colleague of mine says we should.

QUESTION: Why should we have a written investment policy statement?

ANSWER: Although a written policy is not required, it would provide your company with a critical measure of fiduciary liability protection if the plan's investment choices or their performance were challenged.

DISCUSSION: A written investment policy statement is documentary evidence that a carefully considered investment policy exists. A policy statement provides the employer and other plan fiduciaries that are responsible for plan investments with investment management guidelines. It also provides a process for making broad investment management decisions, setting investment goals, and communicating the policy to employees. Without a prudent investment policy, an employer could be found liable for fiduciary shortcomings, including poor investment results.

While the specific needs of each individual plan and sponsor determine what should be included in an investment policy statement, these statements generally include:

- The plan's investment goals.
- Roles and responsibilities of those involved with plan investments.
- Considerations and guidelines used in selecting and replacing investments and investment managers.
- Procedures for monitoring investment performance, directions as to how managers should report performance, and a review schedule.
- A statement deferring to the plan document's provisions if a conflict arises.
- A description of how participants may control their plan account investments, the manner and frequency of investment performance reporting, and what educational materials will be provided to help participants make informed investment decisions.

Once you have established an investment policy, you, as the employer, or the company's benefits committee should review it regularly and revise it as needed.

Measuring Your Plan's Success

Typically, high-performing, successful retirement plans have high participation and contribution rates and a large number of participants who are on the path to a financially secure retirement. Employees who are satisfied with their retirement plan may be more productive and less likely to seek employment elsewhere. And employers who promote plan participation and offer an appropriate selection of investment choices reduce the risk of running afoul of government regulations.
You can evaluate the performance of your company's retirement plan by examining various plan-related metrics.

What should we consider measuring? The specific metrics you choose to measure will depend on the type of plan you have, the data available to you, and other factors. Key items to look at in a 401(k) or similar plan might include:

Participation rate. How many and what percentage of eligible employees actually participate and contribute to the plan? This is a critical metric that can be further refined to determine the participation rates for employees in a specific age bracket or income range.

Contribution rate. It also may be useful to measure the average contribution rates for participants based on their ages or salaries.

Investment education. You can indirectly measure how investment education programs drive participation and contribution rates by tracking how often employees participate in seminars, meetings, and online tutorials that explain the various investment options offered by the plan.

Retirement readiness. What is the average account balance of participants (in dollars and as a multiple of annual income)? How many participants are on target to have enough in their plan accounts to replace a specified percentage (e.g., 75% or 85%) of their projected preretirement income at retirement? The greater the number, the more successful your plan.

What should we do with the data we have collected? First and foremost, evaluate the information you have collected in terms of your expectations for the plan. Also see if you can use the data to compare your plan to plans of a similar size in a similar industry/service and within a common geographic area, i.e., state or region.

Why is benchmarking important? You can use the data you have collected from benchmarking your plan with other plans to help you establish plan goals. For example, if your research indicates that your plan has a 69% participation rate while the average benchmark rate for similar plans is 80%, you can establish a goal to boost your participation rate by 11 percentage points to bring it up to the average level within a certain time period.

Delving deeper into the data you have collected, your research may reveal, for example, that highly compensated employees contribute more (as a percentage of pay) to the plan than non-highly compensated employees. This difference potentially could cause the plan to have problems meeting IRS nondiscrimination rules. You would therefore want to encourage lower paid employees to defer at the appropriate level.

Should the goals be set in stone? Not necessarily. The goals should be viewed as desirable objectives. The ultimate goal is to make the plan perform at the highest level possible. That takes time. The failure to attain a specific goal in an allotted time should not be viewed negatively.

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