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Fiduciary Risk Management

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The Employee Retirement Income Security Act (ERISA) governs a complex and challenging environment. Lawsuits and benefit claims are increasingly brought against ERISA fiduciaries, subjecting them to personal liability and extensive, time-consuming legal proceedings. Plan sponsors can minimize the exposure of their fiduciaries to litigation, reduce the cost of insurance, and enhance the administration of employee benefit programs through sound risk management practices.

Fiduciary Responsibilities

A fiduciary is any person named in the plan instrument or any person who exercises any discretionary authority or control with respect to the plan's management or assets. Fiduciaries typically include the plan sponsor and its trustees, but may include others. The definition of an ERISA fiduciary is deliberately broad and extends beyond the common-law definition to encompass all individuals that might be responsible for the misuse of plan assets or for a loss to plan participants.

The most frequently alleged claims against ERISA fiduciaries include a denial or change of benefits, administrative error, incorrect benefit calculation, improper advice or counsel, misleading representation, wrongful termination of plan, denial of one's civil rights, failure to adequately fund a benefit program, conflict of interest, and imprudent investment. The employees participating in a program bring the majority of fiduciary claims.

The ERISA fiduciary is ultimately responsible for negligence and the failure to administer a plan according to its terms. Participant claims often arise as a result of receiving a lesser benefit than expected, whether resulting from improper administration or inadequate communication. A vague or imprecise summary plan description has often resulted in the payment of benefits not due under the tenns of the plan document.

Fiduciary liability. Fiduciaries that have breached an ERISA fiduciary responsibility provision are personally liable for any resulting lawsuits, and may also be liable for statutory penalties and reasonable attorney fees. Fiduciary liability may also arise from errors or omissions by the fiduciary or a cofiduciary. A lawsuit establishing liability may be brought by the Department of Labor, any plan participant or beneficiary, or another plan fiduciary.

Fiduciary delegation. Fiduciaries are generally not liable for a breach of an ERISA fiduciary duty if that duty has been specifically delegated to another fiduciary. The plan document must specifically authorize the delegation of fiduciary duty and the fiduciary must exercise reasonable prudence in delegating responsibilities.

ERISA fiduciaries often delegate the responsibility for establishing and overseeing plan asset investments. ERISA restricts such delegation to an investment manager that is a registered investment advisor, a bank, or a qualified insurance company, and the investment manager must acknowledge its fiduciary status in writing.

Fiduciaries must act prudently in monitoring delegated responsibility. Fiduciaries must evaluate the performance of the appointee and the appropriateness of continuing that delegation, typically through an annual fiduciary review and an investment policy statement.

ERISA fiduciaries often delegate administrative functions to service providers, which generally are not fiduciaries. Nonetheless, service providers should have written agreements clearly defining their responsibilities. Plan sponsors should consult qualified counsel for guidance in satisfying fiduciary conduct when delegating and they should document their fiduciary conduct, particularly for actions related to investment decisions.

Risk Management Practices

ERISA fiduciaries must ensure that plan and trust documents and sununary plan descriptions fully comply with applicable laws and reflect actual plan operation. Periodic opinions of legal counsel about the conformity of the plan document and its actual operation, including compliance with the applicable statutory requirements and tax qualification provisions, will ensure the accuracy and completeness of regulated filings and communication with plan participants.

Plan sponsors should draft their trust agreements to provide maximum indemnification for ERISA fiduciaries. Prototype plan documentation indemnification provisions are often inadequate and fail to safeguard the plan sponsor's interests.

The employee benefit plan is required to bond any fiduciary and all other persons that handle plan assets. Fidelity bonds reimburse the plan for losses arising from dishonesty but do not protect fiduciaries to the extent claims are made against them. ERISA fiduciaries cannot rely solely upon the fidelity bond and indemnification provided by the plan sponsor. For example, the plan sponsor may become insolvent and unable to pay losses and expenses incurred by the fiduciary. Alternatively, a plan sponsor's board of directors may modify the indemnification provisions to limit protection for fiduciaries.

Fiduciary insurance should be purchased by the employer and not by the plan; if purchased by the plan, the insurer is permitted to recoup its loss from the fiduciary if a breach of fiduciary duty occurs.

If the plan sponsor provides joint coverage of ERISA fiduciaries along with its directors and officers under a single policy, it should be examined to ensure that the intended coverage for ERISA fiduciaries exists and be tested to evaluate the effect of the erosion of the liability limit that occurs when combining two different insurance programs and classes of insured into one policy.

ERISA compliance audits. ERISA compliance audits that inspect and evaluate actual plan operation are an efficient means for plan sponsors to fulfill their obligations for document adequacy, tax compliance, accurate communication to participants and government authorities, and the maintenance of plan procedures. In addition to identifying potential problems in actual plan operation, a compliance audit demonstrates sound business judgment by ERISA fiduciaries and emphasizes to all the necessity for compliance with legal requirements