FEB/MAR 2014 VOLUME 11/NUMBER 1 TODAYSGENERALCOUNSEL.COM

Today's GENERAL COUNSEL

A MOUNTAIN OF INFORMATION

Today's General Counsel E-Discovery Survey: What Companies Are Doing Now

Dress Rehearsal for Litigation Holds

The John Henry Project: One Man Takes On 24,500 Unread Emails

If Your Law Firm Suffers a Data-Breach, You Do Too

Fed Agency E-Discovery Woes

LABOR & EMPLOYMENT
Retaliation Claims
When the Employee-Inventor Leaves
ERISA: 401k Sponsors Can Be Liable

INTELLECTUAL PROPERTY
Creative Damages Theories

MANAGEMENT
Using Metrics You Already Possess
Building "Legal Operations"

Butterflies: When In-house Counsel Is Deposed
Mergers
Arbitration and the Courts
Political Risk in Overseas Ventures

$199 Subscription rate per year
ISSN: 1932-9024

View our digital edition: digital.todaysgeneralcounsel.com

Labor & Employment

New DOL Rules Heighten Duties, Personal Liability, of 401k Sponsors

By Kurt Winiecki

Business owners who offer a 401k plan are required to comply with the Employee Retirement Income Security Act (ERISA), a complex federal statute designed as a consumer protection law. Failure to comply with ERISA exposes business owners and other employees who make important decisions about the plan (like general counsel, the CFO or the human resources director) to personal liability.

Often employees who are delegated plan administrative duties know nothing about ERISA or the personal liability to which they are exposed. This is neither appropriate nor the best way to help employees prepare for retirement. Because plan fiduciaries can be sued personally for imprudent plan decisions, understanding 401k fiduciary responsibility is one of the best ways to protect them from personal loss. This article provides a summary of the new 401k rules, common areas of non-compliance and best practices for administering a 401k plan.

BACKGROUND

Plan participants (employees who participate in the 401k plan) often pay much, if not all, of the plan's investment and administrative services. They pay fees directly from account deductions or through the investments' expense ratios (those ongoing fees a mutual fund or other investment product charges to manage that product). Plan fiduciaries dictate how much plan participants pay for services and are held responsible for those decisions. ERISA requires plan sponsors to ensure plan expenses are reasonable.

Historically, however, 401k plan services and fees have confused plan sponsors. Poor performance reports, misleading sales statements, convoluted fee disclosures and other kinds of reports often fail to provide information in a way that helps a plan sponsor assess services and fees.

As a result of poor reporting, poor service and overpaying for many services, the U.S. Department of Labor recently enacted new rules to help plan sponsors better assess services and fees. The new DOL rules require every plan service provider to give a fee disclosure. Because the DOL's enforcement authority is similar to that of the IRS, failure to comply with these rules can result in serious consequences.

Moreover, lack of familiarity with the new rules may be just the tip of the noncompliance iceberg. The DOL's new rules highlight a trend toward heightened scrutiny of plan administration, fees and decisions. As employees near and enter retirement, they too will scrutinize the prudence of plan decisions more closely.

THE NEW DOL RULES

The new DOL rules require every plan sponsor to obtain and analyze fee disclosures from every plan service provider. The deadline for obtaining the disclosures was July 1, 2012. (Failure to have obtained the appropriate fee disclosures would have been an ERISA violation.) A plan sponsor that requested, but did not obtain, a fee disclosure had to notify the DOL that the service provider failed to provide it and inform the DOL whether the service provider has been terminated.

The plan fiduciary must examine the fee disclosures, focusing on whether the fees are reasonable. Sponsors commonly assess fees in one of two ways: by comparison among the bids for servicing the plan, or by obtaining through a third party a "benchmarking" report that compares the plan's fees to those paid by similar plans. Failure to objectively assess fees opens the door to an argument that the fees are not reasonable.

HIRING FIDUCIARY HELP

When it comes to the investment decisions, the DOL provides guidance. In its publication "Meeting Your Fiduciary Responsibilities," the DOL advises that if a plan sponsor lacks investment expertise, "a fiduciary will want to hire someone with that knowledge to carry out the investment ... functions."

The DOL has also published a fact sheet entitled, "How to Tell Whether Your Adviser is Working in Your Best Interest: A Fiduciary Guide for Individual Consumers." It advises individual investors "to make sure the adviser you select is working in your best interest," but hiring a fiduciary advisor over a non-fiduciary is prudent advice for 401k plan sponsors, as well.

Hiring a fiduciary advisor and understanding what they are and are not responsible for is important to understand a plan fiduciary's personal risk. Unfortunately, many plan fiduciaries wrongly believe that when they hire an investment company, a bank, a Wall Street firm or an insurance company, they are fulfilling their fiduciary responsibilities.

Often, those entities and their sales reps have no fiduciary duty to the plan participants. Equally problematic are those "fiduciary" advisors that exploit conflicts of interests that place the advisor's interests ahead of the plan participants' interests.

One way this can happen is when plan sponsors who use an investment company for services also use the company's investment products for most or all of the plan's investments. Using companies that have a financial incentive to sell certain products often results in investment choices that are not in the plan participants' best interests, violating a plan fiduciary's duty to offer only the best investment solutions to its plan participants.

Some plan fiduciaries hire a "financial advisor" to help choose investments. However, a "financial advisor" is not a fiduciary. They may be highly incentivized by money, bonuses, or trips to sell plans certain investment products. A plan fiduciary may believe the financial advisor offers investment expertise, when actually the advisor is simply selling certain products in his or own best interest.

Accordingly, accepting biased recommendations from a non-fiduciary entity or advisor, without a comparative analysis, is not prudent. It runs counter to ERISA and subjects the plan fiduciaries to risk.

ERISA requires prudent decisions. Using investment options from only one company may be prudent, but that must be demonstrated in order to protect the plan fiduciaries. Plan fiduciaries must use a process for investment selection - that duty falls entirely on the plan fiduciaries, not on a biased seller of products.

Both the decisions and the decision-making process must be documented. If the funds perform poorly, it is the documentation in the files that will demonstrate that a prudent decision was made. Importantly, monitoring each investment option is an ongoing duty. Winning a "prudence" argument is nearly impossible without documentation.

Help is available through a Registered Investment Advisor. RIAs are legal fiduciaries, who like the plan fiduciaries act in the best interests of the plan participants. RIAs should declare their fiduciary status in writing and have a documented procedure to choose and monitor investment choices.

Some fiduciary investment advisors are co-fiduciaries: They share the responsibility for investment decisions, which does not relieve the plan fiduciaries of responsibility. Other fiduciaries take full fiduciary responsibility for investment decisions, relieving the plan fiduciaries of any liability for investment options.

Hiring a fiduciary is more problematic than one might think. It often leaves plan fiduciaries with the impression they are responsible for nothing. This is a serious legal disconnect, because ERISA imposes many duties beyond investment choices on plan fiduciaries. They often fail to realize that, for example, they must monitor the plan service providers using the new DOL Fee Disclosure rules. They must also provide plan participants with disclosures about fees, plan information and investment performance.

ERISA is a complex federal law that exposes knowing and unknowing plan fiduciaries to personal liability. This is an area getting more scrutiny from Congress, the DOL, attorneys, the press and employees. Failure to understand and comply with responsibilities under ERISA can have dire personal consequences, for plan fiduciaries and participants alike. ■

Kurt Winiecki, formerly a law firm attorney, began a financial services career in 2007. In 2011, he founded Winiecki Wealth Management, a Registered Investment Advisor that provides fiduciary advice to 401(k) plan sponsors. He is a CPA and an Investment Advisor Representative registered with the state of Illinois.
kurt@winieckiwealth.com