QPA WHITE PAPER SERIES

The Value of a Fiduciary

By: Matthew J. Eickman, J.D., AIF®
Director of ERISA Services

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The Value of a Fiduciary

I. Introduction

Why did the Department of Labor (DOL) spend more time on the fiduciary definition over the last 10 years than on any other topic? Because it recognizes the importance of fiduciary status and the value a fiduciary provides. That recognition is clearest when the DOL addresses the misunderstanding, misrepresentations, and conflicts that a *non*-fiduciary presents. This White Paper is for plan sponsor representatives who desire to know more about key fiduciary issues: (1) the high standards applicable to a fiduciary; (2) a fiduciary's core responsibilities; (3) the danger of working with a non-fiduciary; and (4) what they should expect from a strong fiduciary partner. Whether you would categorize yourself as a fiduciary, non-fiduciary, trustee, plan administrator, committee member, human resources professional, or some combination thereof, this White Paper is for you.

II. The Highest Duty Known to Law

"A fiduciary's duties are the highest known to law."[i] There is no better place to begin a review of fiduciary responsibilities than to recognize the ultimate status Federal courts assign to fiduciary responsibility. Consider the wide array of issues the courts consider day after the day. Yet among the vast field of potential duties, the courts consistently regard a fiduciary's duties as the highest.

ERISA, the federal act that created the statutory fiduciary duties is an acronym for the "Employee Retirement Income Security Act of 1974". In order to secure employees' future rights to retirement income, Congress adopted ERISA and codified fiduciary responsibilities derived from common trust law.[ii] ERISA serves to impose trust law standards of care and undivided loyalty, and to hold fiduciaries accountable when they breach those obligations. As the DOL has noted, "fiduciary status and responsibilities are central to protecting the public interest in the integrity of retirement and other important benefits, many of which are tax-favored."[iii]

III. The Core Fiduciary Responsibilities

ERISA imposes four explicit responsibilities upon a fiduciary.

A. Duty of Loyalty

A fiduciary must discharge his or her duties "solely in the interest of the participants and beneficiaries", and for the exclusive purpose of providing them benefits and defraying reasonable administration expenses.[iv] One may succinctly summarize this most fundamental duty[v] as a duty of undivided loyalty.[vi] As one federal court said, it requires that a fiduciary "act with an eye single to the interests of plan participants and beneficiaries."[vii]

B. Duty of Prudence

A fiduciary must discharge his or her duties with the "care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters" would use in a similar situation.[viii] Take note of the two halves of this responsibility. The first requires care, skill, prudence, and diligence, which combine to require a prudent process. The second imposes a higher standard for that process: what would be prudent if it were conducted by one "familiar with the matters". Simply put, ignorance is no excuse.

C. Duty to Diversify Investments

A fiduciary must diversify plan investments so as to minimum the risk of large losses, unless under the circumstances it is clearly prudent not to do so.[ix] This is a facts and circumstances test; there is no specific percentage limit on any one investment.[x] One federal court astutely interpreted this as an expectation to not only utilize multiple investments, but also to diversify among investment managers.[xi]

D. Duty to Follow Plan's Terms

A fiduciary must act "in accordance with the documents and instruments governing the plan" insofar as they are consistent with Federal law.[xii] This responsibility may be burdensome. It also may be convenient; it offers fiduciaries clear direction regarding the authority controlling potentially challenging participant or beneficiary inquiries.

IV. The Danger of Working with a Non-Fiduciary

A fiduciary's value is clear. It becomes even clearer when compared to the dangers of working with a non-fiduciary. Consumer protection drove the DOL to spend several years on a new fiduciary standard. Consumer protection drove the DOL's attempt to expand that standard to apply to more financial professionals and other service providers. Consumer protection drove the DOL to share numerous observations about the differences between a fiduciary and a non-fiduciary:

- Non-fiduciaries may put their interests above the investor's. This means they may: "give imprudent and disloyal advice"; steer investors to investments "based on their own, rather than their customers' financial interests"; and act on conflicts in "ways that would be prohibited if the same persons were fiduciaries."[xiii]

- Non-fiduciaries need not disclose those conflicts.[xiv]

- Investors misunderstand the degree of responsibility their non-fiduciary provider owes – *or doesn't owe* – them.[xv]

- Following such biased advice can inflict losses on investors in several ways. They may choose more expensive and/or poorer performing investments. They may trade too much and thereby incur excessive transaction costs. They may chase returns and incur more costly timing errors, which are a common consequence of chasing returns.

- Non-fiduciaries have limited liability under federal pension law for any harms resulting from the advice they provide.[xvi]

The DOL's observations tell a scary story. Non-fiduciaries may put their interests above their clients, but they need not disclose these potential conflicts and investors may not understand the absence of a higher responsibility on the non-fiduciary's behalf. Acting on this advice may cause harm in several ways, yet non-fiduciaries are unlikely to face any liability under ERISA for such harm. Even scarier – at least one federal court held that a provider otherwise serving as a fiduciary may avoid liability by unilaterally serving as a non-fiduciary with respect to a particular investment.[xvii] It should not be this easy, particularly because one's fiduciary status is a functional test (that is, whether one exercises authority or control over the management or disposition of a plan's assets).[xviii] Yet the recent abandonment of a broader fiduciary standard is likely to leave more plan fiduciaries and participants open to cavalier behavior from non-fiduciaries and without recourse when that behavior causes damage.

V. Closing Thoughts: What to Expect From a Fiduciary

The DOL's fiduciary initiative shone a bright spotlight on fiduciaries and their responsibilities. Some brokers, advisors, and other service providers took great pleasure in a Federal court's decision to strike down a broader fiduciary standard that would have provided more protection for plan sponsors and their employees. Others embraced the DOL's broader standard. How can a plan sponsor ensure that it works with a provider that falls into that latter category?

- Ask the advisor or broker if he or she serves in a fiduciary capacity. The answer should be an unequivocal "yes".

- If the answer is indeed yes, ask to see that acknowledgement in writing. The written acknowledgement should not suggest that he or she "helps with fiduciary responsibilities", but instead must clearly say "I am a fiduciary under ERISA."

- Demand that the fiduciary be able to explain its fiduciary responsibilities, particularly the duties of loyalty and prudence.

- Ask how the fiduciary will help with your duty to monitor service providers. Although you might be able to shift certain responsibilities to a fiduciary, the good ones recognize that ERISA still holds the responsible plan fiduciaries accountable for monitoring providers.

- Seek education and training. There is no shortage of recent fiduciary guidance from the DOL and Federal courts. A strong fiduciary advisor will ensure that a plan sponsor's internal fiduciaries are educated regarding their responsibilities, and how regulatory and litigation developments impact those responsibilities.

These steps will help plan sponsors to uncover whether their service providers are proactive, knowledgeable, and willing fiduciaries – or whether they're non-fiduciaries ill-equipped or unable to fulfill the highest duty known to law.

Questions? Contact the author:

meickman@qualifiedplanadvisors.com

402.507.5085

[i] *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982), *cert denied*, 459 U.S. 1069 (1982).
[ii] *Central States, Southeast & Southwest Areas Pension Fund* v. *Central Transport, Inc.*, 472 U. S. 559, 570 (1985).
[iii] 81 Fed. Reg. 20,946, 20,946 (2016).
[iv] 26 U.S.C. §§ 1103(c)(1) & 1104(a)(1)(A).
[v] *Pegram et al v. Herdrich*, 530 U.S. 211, 224 (2000).
[vi] *Id.* at 235.
[vii] *Donovan v. Bierwith*, 680 F.2d 263, 271 n.8 (2d Cir. 1982), *cert denied*, 459, U.S. 1069 (1982).
[viii] 26 U.S.C. § 1104(a)(1)(B); *Fifth Third Bancorp* v. *Dudenhoeffer*, 573 U. S. ___, 134 S. Ct. 2459 (2014).
[ix] 26 U.S.C. § 1104(a)(1)(C).
[x] *Marshall v. Glass/Metal Ass'n & Glaziers & Glass-workers Pension Plan*, 507 F. Supp. 378, 383 (D. Haw. 1980) *Lanka v. O'Higgins,* 810 F. Supp. 379, 387 (N.D.N.Y. 1992); *Reich v. King*, 861 F. Supp. 379, 383 (D. Md. 1994).
[xi] "Under the duty of diversification, the trustee should not normally invest all or an unduly large portion of plan funds in a single security, or in any one type of security, or even in various types of securities that depend on the success of one enterprise." *Bruner v. Boatmen's Trust Co.*, 918 F. Supp. 1347, 1353 (E.D. Mo. 1996).
[xii] 26 U.S.C. § 1104(a)(1)(D).
[xiii] 81 Fed. Reg. 20,946, 20,946 (2016).
[xiv] 81 Fed. Reg. 20,946, 20,946 (2016).
[xv] 81 Fed. Reg. 20,946, 20,950 (2016).
[xvi] 81 Fed. Reg. 20,946, 20,946 (2016). Contrast that with ERISA's clear imposition of responsibility against a fiduciary who breaches his or her responsibilities under ERISA.
[xvii] *Tiblier v. Dlabal*, 743 F.3d 1004 (5th Cir. 2014).
[xviii] *Lockheed Corp. v. Spink*, 517 U.S. 882, 890 (1996).