

Responsibilities Of Retirement Plan Trustees -- And What To Do About It

The Employee Retirement Income Security Act of 1974 (“ERISA”) generally governs qualified retirement plans (pension plans, profit sharing plans, 401(k) plans and their variants). ERISA imposes certain duties and responsibilities on the “fiduciaries” who are responsible for the administration of those retirement plans.

ERISA defines the term “fiduciary” to include any person who:

- Exercises any discretionary authority or control with respect to plan assets.
- Renders investment advice as to plan assets for a fee.
- Has discretionary authority or responsibility in the administration of the plan.

This definition usually covers the employer that sponsors the plan, plan administrators, members of any administrative committee, investment managers and plan trustees.

A trustee of a qualified retirement plan is the entity or group of individuals who hold the assets of the plan in trust. Trustees are either designated in the plan document or appointed by another fiduciary, typically the employer who sponsors the plan. The trustees usually have exclusive authority and discretion over the management and control of plan assets unless the plan document provides otherwise by, for example, delegating control over investment decisions to an “investment manager” or to participants in self-directed plans.

General Duties

Trustees have certain general duties with respect to the way they manage and administer the qualified plan for which they are responsible. Those duties include the following:

1. Trustees must administer the plan in accordance with the documents and instruments governing the plan.
2. Trustees must administer the plan for the exclusive benefit of plan participants and their beneficiaries.
3. Trustees must act in accordance with the standard of care established under ERISA, that is, the “care, skill, prudence and diligence . . . that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims[.]”

4. Trustees must diversify plan investments in order to minimize the risk of large losses (unless it is clearly prudent not to do so).

5. Trustees must not permit the plan to engage in the “prohibited transactions” described in ERISA, which include, subject to specific statutory and administrative exemptions, any sale, exchange or transfer of assets, goods or services between the plan and any “party in interest” (employer, employee, fiduciary, persons providing services to the plan and related parties).

6. Trustees must value qualified plan assets at least annually at “fair market value.”

ERISA Prohibitions

Trustees must not engage in transactions which violate the following specific ERISA restrictions on fiduciary conduct:

- Trustees and other fiduciaries cannot deal with plan assets for their own account (i.e., self-dealing).
- Trustees and other fiduciaries are not to act in a transaction involving the plan on behalf of a party whose interests are adverse to those of the plan (i.e., engage in conflicts of interest).
- Trustees and other fiduciaries are not allowed to receive compensation from any party dealing with the plan in connection a transaction involving plan assets (the “anti-kickback” provision).
- Trustees who receive “full-time pay” from an employer that sponsors a plan may serve as trustees, but they are not entitled to receive compensation from the plan for acting as trustees. Such trustees are permitted reasonable expense reimbursement.

Fiduciary Liability

If a trustee breaches any of the responsibilities, obligations, or duties imposed by ERISA, the trustee will be personally liable to reimburse the plan for any losses resulting from the breach. The trustee will be responsible for restoring to the plan any profits that he or she made through the use of plan assets. A civil action may be brought by a participant or beneficiary, or by another

fiduciary. In addition, the fiduciary will be subject to equitable or remedial relief as a court may deem appropriate, such as removal of the fiduciary. Even if a trustee delegates some of his or her fiduciary duties to others, the trustee is not completely relieved of fiduciary responsibilities because the trustee is obligated to monitor the performance of those to whom the duties have been delegated.

If a trustee is held liable for breach of fiduciary duty, by court order or settlement with the Department of Labor, a civil penalty equal to twenty percent of the amount of such liability will be assessed. This penalty may be waived or reduced if the trustee acted reasonably and in good faith.

Participant Loans

Just as some trustee duties may be allocated to others by the plan document, additional duties may be allocated to the trustees. Trustees are frequently designated as being responsible for participant loans.

Plan loans to participants are not treated as prohibited transactions under ERISA if the following conditions are satisfied:

1. Loans are available to participants and beneficiaries on a reasonably equivalent basis;
2. Loans are not made available to highly compensated employees in an amount greater than the amount made available to other employees;
3. Loans are made in accordance with specific provisions that are set forth in the plan;
4. Loans bear a reasonable rate of interest; and
5. Loans are adequately secured.

To the extent the trustees are required to enforce a standard set forth in the plan document for granting (and denying) participant loans, they may be involved in fact-finding relating to a particular loan application and in applying the loan "policy" on the basis of such fact-finding. This type of decision making can always be second guessed by a participant whose loan application is rejected. Alternatively, all participant loans that meet the statutory criteria can be granted regardless of the applicant's circumstances. This would remove the trustees from the duty of making specific decisions on who should be granted plan loans at the expense of losing control over the use of loan proceeds by participants.

Department of Labor regulations require “the basis on which loans will be approved or denied” to be included in a written “loan program” which comprises a part of the plan, although it may be set out in a separate document. The loan program also must include:

1. The identity of the persons authorized to administer the participant loan program (typically the administrative committee or the trustees);
2. A procedure for applying for loans;
3. Limitations (if any) on the types and amounts of loans offered;
4. The procedures under the program for determining a reasonable rate of interest;
5. The types of collateral that may secure a participant loan; and
6. The events constituting default and the steps that will be taken to preserve plan assets in the event of such default.

The Department of Labor’s loan program requirements address the primary concerns of the trustees in administering participant loans: the basis for granting and denying loans, the procedure for determining a reasonable rate of interest and security for participant loans. Following a written loan program (as well as the plan document) will go a long way to providing a defense to the trustees in the event their denial of a loan application is contested.

The determination of a reasonable rate of interest for a particular participant loan may require a survey of several local banks to determine what rate of interest they would charge for similar loans. This is because the Department of Labor has never prescribed an interest rate or formula for determining a reasonable rate of interest, although opinion letters have observed that a rate equal to the “prime rate” plus one or two percent would be reasonable in particular circumstances.

Participant loans also must be adequately secured, and the participant’s vested accrued benefit under the plan may be assigned as security. However, no more than fifty percent of the present value of a participant’s vested accrued benefit may be used as security for a plan loan. Consequently, for loans of more than fifty percent of a participant’s vested accrued benefit (which are permitted only for loans of up to \$10,000), security in addition to the participant’s benefits in the plan (such as a pledge of personal assets) will be required.

Mitigation of Liability

Any trustee should consider various means of limiting personal exposure for claimed breaches of fiduciary duty. Generally, provisions in a plan document which relieve trustees from liability for breaching their fiduciary duties are void under ERISA. This means that the exculpation and indemnification of trustees by the plan is prohibited. However, the indemnification of trustees by the employer which sponsors the plan is permitted. Indemnification of trustees who are officers or directors may already be provided in separate documents, such as the company's by-laws.

Other approaches to the mitigation of fiduciary liability include:

- Secure fiduciary liability insurance which covers liability and losses resulting from the acts or omissions of plan fiduciaries. This coverage should not be confused with the required fidelity bond, which protects only the plan. Such fidelity bonds permit recourse by the insurer against a trustee who engages in a breach of fiduciary duty.
- Delegate responsibility for investment decisions to an investment manager. This can be accomplished by action of the employer taken in accordance with any provisions relating to investment managers set forth in the plan document.
- Allocate certain duties to others in accordance with plan procedures so that the scope of the trustees' duties is reduced. For example, an individual who is not a trustee may be designated as a fiduciary responsible for the participant loan program.
- Allow participants to make their own investment decisions as to their accounts in the Savings Plan. If participant investment direction is implemented in accordance with Section 404(c) of ERISA, the trustees will be relieved of liability for the participant's investment decisions as to the participant's own account. Section 404(c) of ERISA requires the plan to provide participants a choice among at least three investment alternatives which are diversified and have materially different risk and return characteristics. For participants with smaller accounts, the plan will be required to provide a "look-through" vehicle (such as mutual funds, collective trust funds, fixed rate investment contracts of an insurance company, pooled insurance company investment accounts and the like) in order to assure the requisite degree of investment diversification.

- Exercise procedural prudence by conducting regular trustees' meetings, keeping minutes of the meetings and documenting the basis for decisions made, particularly investment decisions and decisions concerning applications for participant loans.

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