

Fiduciary Education – A Necessary Requirement For Plan Fiduciaries

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Persons who have discretionary authority or control over the administration or management of the assets of an ERISA-covered pension or welfare benefit plan, such as a tax-qualified 401(k) plan, are treated as “fiduciaries” with respect to such plans. Fiduciaries under ERISA are held to a very high standard of conduct, and accordingly, are subject to a number of important duties and responsibilities.

Fiduciary Duty Penalties

Failure to comply with an ERISA fiduciary’s duties and responsibilities can expose the noncompliant plan fiduciary to, among other things, personal liability to the plan to make it whole for any losses incurred by the plan, or to return to the plan any profits derived by the fiduciary, due to the fiduciary’s breach of responsibility. In addition, a breach or violation of fiduciary responsibilities may result in the assessment by the U.S. Department of Labor (“DOL”) of a civil penalty on the fiduciary (or other person who knowingly participated in the fiduciary’s breach or violation) of 20% of the amount recovered from the fiduciary or other person. Further, the occurrence of a nonexempt prohibited transaction can result in the imposition of excise taxes under the Internal Revenue Code (the “Code”) on the persons engaging in the prohibited transaction with the plan.

Beyond these personal liabilities, penalties, and excise taxes, fiduciary violations under ERISA can give rise to other types of monetary penalties (e.g., failure to timely file annual plan returns) and court-imposed equitable remedies.

Fiduciary Education

The DOL, in its audit of ERISA-covered plans, seeks written documentation from plan fiduciaries of their knowledge of ERISA fiduciary duties and responsibilities. Accordingly, to avoid fiduciary breaches and related liabilities and penalties, and to satisfy a DOL requirement in connection with plan audits, a plan fiduciary needs to understand and abide by his fiduciary duties and responsibilities under ERISA.

The first step in that compliance process is for a plan fiduciary to know and understand what his duties are under ERISA. It will be an almost impossible task to comply with a fiduciary’s duties under ERISA if the fiduciary is unaware of what those duties and responsibilities are in the first place. Below is a brief discussion of a fiduciary’s duties under ERISA and of the prohibited transactions under ERISA and the Code. Certain other fiduciary requirements and the liability consequences thereof (such as fidelity bonds and compliance with fiduciary requirements under applicable case law governing fiduciary conduct) are beyond the scope of this article, but still quite relevant.

Fiduciary Duties

Under ERISA, a plan fiduciary must act:

- solely in the interests of plan participants and their beneficiaries;
- for the exclusive purpose of providing benefits and paying reasonable expenses of administering the plan;
- prudently;
- to diversify plan investments to minimize the risk of large losses (unless it is clearly not prudent to do so); and
- in accordance with the terms of the governing plan documents to extent such terms are consistent with ERISA.

Courts have recognized that ERISA fiduciary duties constitute the highest standards of care and conduct required and impose on a fiduciary a duty to act with an “eye single” to the interests of the plan and its participants. Moreover, a fiduciary’s good faith intentions will not prevent noncompliant actions from constituting a fiduciary’s breach of duty or resulting in the occurrence of a prohibited transaction.

Prohibited Transactions

In addition to the above-mentioned fiduciary duties, a plan fiduciary must manage and administer the plan in a manner that avoids certain ERISA- (and Code-) prescribed prohibited transactions. It is noted that the prohibited transaction rules under the Code generally mirror the prohibited transaction rules under ERISA.

Prohibited transactions under ERISA are of two types. First, there are prohibited transactions reflecting a fiduciary’s duty of undivided loyalty. These prohibited transactions require that a fiduciary not permit a plan to engage in a transaction with certain persons that have a close relationship to the plan (e.g., employer/plan sponsor, plan fiduciary, certain family-based relatives of the plan fiduciary), known under ERISA as a “party in interest.” Such prohibited transactions include a direct or indirect:

- sale, exchange, or lease of property;
- lending of money or other extension of credit;
- furnishing of goods, services, or facilities;
- transfer to, use by, or for the benefit of, a party in interest of any assets of the plan; and
- acquisition or holding by a plan of employer securities or employer real property (unless certain conditions are met).

Second, ERISA’s prohibited transactions are also intended to prevent fiduciary self-dealing. Accordingly, a fiduciary is prohibited from:

- using plan assets for the fiduciary’s own interest or account;
- acting in connection with a transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan; and
- receiving consideration for the fiduciary’s personal account from any party to a transaction involving the plan.

Notwithstanding that certain transactions would be in the first instance prohibited transactions, some transactions are nonetheless permissible if a prohibited transaction exemption applies. Prohibited transaction exemptions take the form of statutory, class, or individual exemptions. An analysis of specific prohibited transaction exemptions is beyond the scope of this article.

Conclusion

A prudent plan fiduciary will need to review and understand the nature and scope of his fiduciary duties and the prohibited transaction rules under ERISA and the Code. A failure to do so can result in significant liability and penalties for the plan fiduciary and plan sponsor/employer. Thus, it is strongly recommended that employers/plan sponsors and plan fiduciaries seek advice concerning fiduciary education.