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Delegation for Plan Sponsors

by W. Scott Simon | 04-02-09

There is a widespread misconception even among many otherwise well-informed employee benefits attorneys that sponsors of qualified retirement plans such as 401(k) plans cannot delegate their day-to-day administrative and investment fiduciary responsibilities and liabilities to others.

This is not true. In fact, ever since President Gerald Ford gave life to the Employee Retirement Income Security Act with the stroke of his pen on Labor Day 1974, plan sponsors have been able to not only delegate virtually all of their fiduciary responsibilities but also their liabilities related to those responsibilities. A plan sponsor (via its board of directors), however, will always retain a residual, final fiduciary responsibility to monitor and decide whether those to whom it has delegated--my suggestion would be a professional named fiduciary--should continue in their position. All discretionary duties (and hence responsibilities and liabilities) can, at the option solely of the plan sponsor, remain with the named fiduciary until the plan sponsor decides to take them away from that fiduciary. This should comfort those plan sponsors who fear "losing control" of their plan.

A new series in this column will explain how plan sponsors can delegate their responsibilities and liabilities to a professional named fiduciary--without losing control of their plan--and let the fiduciary, in effect, run the plan. This allows plan sponsor executives to, in effect, get the heck out of the retirement plan business, thereby freeing them to concentrate fully on their business so they can stay in business during these troubled times.

Back (Yet Again) to the Basics of ERISA

When the executives of a business decide to establish a retirement plan such as a 401(k) plan, it's been my experience that virtually none of them have the foggiest idea about the nature of the significant bundle of responsibilities and liabilities which, by law, the fiduciaries (typically the executives) of the plan must assume.

The law to which I refer, of course, is ERISA which requires that all assets (except insurance contracts) of qualified retirement plans such as 401(k) plans be held in trust. Those deemed responsible for investing and managing 401(k) plans most therefore live up to the standard of trust law. That standard, which is the highest known in law, has been described this way: "By declaring that all retirement assets are held in trust, [participants and their beneficiaries] are guaranteed the highest standard of conduct in the management and investment of assets for retirement that the law can establish. A trustee carries the greatest burdens of care, loyalty and utmost good faith for the beneficiaries to whom he or she is responsible."

This alludes to language in ERISA section 404(a) which lies at the heart of ERISA. The duties required of fiduciaries under ERISA section 404(a) include ensuring compliance with the great sole interest and exclusive purpose rules, the prudent man rule, the duty to expend only reasonable costs, the duty of diversification and the duty to follow plan documents and instruments unless their terms violate ERISA.

It's bad enough that virtually no business executives are aware that they bear significant fiduciary responsibilities and liabilities for the plans they sponsor. What's even worse is that breach of these responsibilities by such executives can result, under section 409(a) of ERISA, in personal liability for them. ERISA Interpretive Bulletin 96-1 spells this out: "Fiduciaries of an employee benefit plan [such as a 401(k) plan] are charged with carrying out their duties prudently and solely in the interest of participants and beneficiaries of the plan, and are subject to personal liability to, among other things, make good any losses to the plan resulting from a breach of their fiduciary duties."

When business executives serve as sponsors of 401(k) plans, then, they must at a minimum: (1) live

up to the standard of trust law which is the highest known in law; (2) comply with the sole interest and exclusive purpose rules, the prudent man rule, the duty to expend only reasonable costs, the duty to diversify broadly, and the duty to follow plan documents and instruments unless their terms violate ERISA; and (3) become subject to personal liability.

The Original Vision of ERISA

ERISA was designed originally with the overarching thought that qualified retirement plans such as a 401(k) plan were to be run by professional fiduciaries, not by plan sponsor executives with little (or no) experience (much less time or interest) in running a plan. The many sections of ERISA that grant fiduciary delegating authority attest to this.

Sadly, this vision of qualified retirement plans being run prudently by professional fiduciaries--whose conduct is subject to a standard of fiduciary prudence--has been distorted by the retirement plan industry in a number of ways over the years. One way is that the industry has convinced plan participants that participants have the ultimate legal responsibility for investing in their own plan accounts. This erroneous view was voiced by California congressman Howard P. "Buck" McKeon at a Congressional hearing in 2007: "The topic of today's hearings, the 401(k) fees, are one of many factors such as historical performance and investment risk for each plan option, which plan participants do have responsibility to consider when investing in a 401(k) plan."

A clear-eyed view of ERISA--undistorted by the self-interested message of the retirement plan industry, which much too often runs diametrically opposed to the best interests of plan participants and their beneficiaries, in my opinion--reveals, however, its original intent that participants are to rely upon, and receive protection from, a fiduciary-based system.

In fact, it is not plan participants that have the ultimate legal responsibility for investing in their plan accounts (although they can be permitted to invest on a restricted basis) but plan fiduciaries. For example, even in the safe harbor of ERISA section 404(c), where plan fiduciaries are rendered legally immune to the consequences of dumb investment decisions made by plan participants, fiduciaries still remain responsible for selecting and monitoring the specific investment options offered to participants in the plan. While participants can be permitted to choose whatever food they want, it is plan fiduciaries which still have the legal responsibility to ensure that the food on the menu from which participants make their choices is--and remains--healthy.

Another way that the retirement plan industry has distorted ERISA's original vision of 401(k) plans run prudently by professional fiduciaries is that few service providers ever assume any fiduciary responsibilities. (This is true even when these providers state that they are fiduciaries--even in their own written contracts--but whose attorneys in the same contracts render that representation legally worthless. My [four-part series](#) in this column nearly three years ago documented in detail this kind of underhandedness.)

The retirement plan industry remains committed to a transactional-based sales model in which nonfiduciary salespeople largely control the information flow to plan fiduciaries, thereby feeding a "process"--acquiesced in by fiduciaries--that is primarily one of moving money from one set of poorly diversified and high- (and hidden) cost investment options to another set of equally imprudent investment options.

Fulfilling the Original Vision of ERISA

There is a relatively easy way for conscientious sponsors of 401(k) plans to help ensure that their plans are run prudently by professional fiduciaries in accordance with the original vision of ERISA. Such sponsors need merely to appoint a professional named fiduciary that will implement the dictates of a strict fiduciary service model.

The terms of that appointment must include a clear statement that all responsibilities are being delegated to the named fiduciary except for the residual monitoring responsibilities that cannot ever be delegated by the sponsor of a qualified retirement plan under ERISA (or any other body of fiduciary law, for that matter). The critical objective here is to delegate full day-to-day discretion (and therefore attendant responsibilities and liabilities) over a plan's administrative and investment

functions to the professional named fiduciary. Under ERISA, if discretion is taken away from a plan sponsor, it has no responsibility, and if it has no responsibility, voilà, it has no liability.

Plan sponsors that delegate their administrative and investment responsibilities and liabilities to a professional named fiduciary can achieve two important goals at the same time. First, sponsors can minimize their risks related to their conduct concerning operational and administrative duties as well as their risks related to their conduct concerning investment duties. Second, a plan sponsor appointing a professional named fiduciary can help maximize wealth for plan participants by offering plan investment options that are lower in cost and broader in diversification of risk--both of which go straight to the bottom line of increased return.

Some plan sponsor executives might believe that delegating significant fiduciary responsibilities (and corresponding liabilities) that they are otherwise legally required to bear will result in their retirement plans spinning out of control and them landing personally in hot (legal) water.

In fact, it is safe, easy and eminently prudent for such executives to delegate their fiduciary responsibilities as well as the liabilities that go along with them. In next month's column, I will discuss exactly how this can be done so that executives can get back to focusing on their business in order to stay in business instead of worrying about fiduciary risks they are neither prepared nor trained to manage.

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