

▶ Fiduciary Reference Guide

A comprehensive resource for understanding your fiduciary duties.



Executive Summary:

Employee benefit plans, including retirement plans, offer many benefits for both you the employer and your employees. Although the Employee Retirement Income Security Act of 1974, as amended (ERISA), has long imposed standards on those who manage such plans, increased retirement plan litigation and media attention has drawn considerable focus on employee benefit plan governance. Given this scrutiny, it is imperative that employee benefit plan fiduciaries understand their responsibilities and continually adhere to the standards that apply to them. The information on the following pages is designed to provide a detailed overview of ERISA's provisions to assist you in complying with ERISA's fiduciary responsibilities and other requirements.

Simply put, anyone who (i) exercises any discretionary authority or discretionary control over the management of a plan, or exercises any authority or control over the management or disposition of plan assets; (ii) renders investment advice to a plan for a fee,

or has any authority or responsibility to do so; or (iii) has any discretionary authority or discretionary responsibility over the administration of a plan must meet ERISA's fiduciary standards by fulfilling four basic duties.

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Smart move.®



The four core fiduciary duties established by ERISA

1. The duty to act prudently.

Fiduciaries must discharge their duties prudently. In order to satisfy this duty, a fiduciary must use the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of a like enterprise with like aims.

2. The duty to act with loyalty and for the exclusive benefit of participants and beneficiaries.

Fiduciaries must discharge their duties solely in the interest of and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.

3. The duty to diversify plan assets.

Fiduciaries must diversify plan assets so as to minimize the risk of large losses, unless it is clearly prudent not to do so under the circumstances. Note: Each plan investment should be considered as part of the plan's entire portfolio.

4. The duty to act in accordance with the plan's governing documents and instruments.

Fiduciaries must discharge their duties in accordance with the documents and instruments governing the plan to the extent that they are consistent with ERISA.

This guide is provided for informational purposes only. It is not intended to constitute legal or tax advice. You should consult your professional, legal, or tax advisors with specific questions about your individual situation.

In addition to the fiduciary duties, ERISA imposes other requirements, including that the plan must be established and maintained pursuant to a written instrument (i.e., a plan document); that plan assets must be held in trust subject to a few limited exceptions; that the plan administrator must meet certain reporting and disclosure obligations; and that fiduciaries and others who handle plan assets must meet certain bonding requirements. Failure of a plan to meet these requirements exposes fiduciaries to liability. Furthermore, ERISA prohibits certain types of transactions related to employee benefit plans and, combined with provisions in the Internal Revenue Code of 1986, as amended (“Code”), imposes significant liability on those who engage in such transactions.

Because the consequences of breaching your fiduciary responsibilities can be significant, including personal liability, you may want to consider the following strategies, which are further detailed in Section 2, beginning on page 16:

Process and documentation. Among the easiest and most effective things a fiduciary can do are the following:

- Establish and follow procedures for fiduciary decisions and plan oversight
- Document the steps and reasons underlying fiduciary decisions

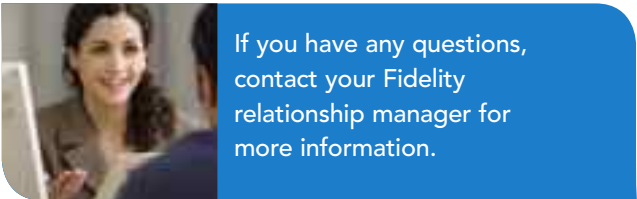
Understand and follow the ERISA section 404(c) requirements. Even though participants generally direct their investments in 404(c) plans, fiduciaries need to prudently select and monitor the investment options available for participant direction in the plan. The implementation of an investment policy statement may be helpful.

Understand co-fiduciary liability. Under certain circumstances, you can be held liable for a breach by a co-fiduciary.

Educate participants. Beyond the required disclosures, many employers choose to provide education and guidance in order to help participants make informed decisions.

Follow a due diligence process in hiring and retaining service providers. Plan fiduciaries should choose the plan service provider that will be best for the plan, not necessarily the least expensive. Fiduciaries should also monitor service providers and ensure that fees charged to the plan are reasonable for the services provided.

Please review the following pages for more detail. We hope this guide helps you understand the responsibilities that go along with being an ERISA fiduciary so that you can mitigate your fiduciary risk while helping your employees build a financially secure and rewarding retirement.



If you have any questions, contact your Fidelity relationship manager for more information.

▶ Section 1: Overview of ERISA fiduciary rules

Who is a fiduciary?

Named fiduciaries

Every employee benefit plan must provide for one or more “named fiduciaries” with the authority to control the operation and administration of the plan. The named fiduciary is identified in the plan document or pursuant to a procedure specified in the plan. In addition, ERISA defines other roles such as investment manager, plan administrator, discretionary trustee, and investment advisor as fiduciary roles.

Functional fiduciaries

An individual who is not serving in a fiduciary role as discussed above may become a fiduciary by performing fiduciary functions. ERISA provides that a person is a plan fiduciary to the extent he/she:

- (i) exercises any discretionary authority or discretionary control over the management of a plan, or exercises any authority or control over the management or disposition of plan assets;
- (ii) renders investment advice to a plan for a fee, or has any authority or responsibility to do so; or
- (iii) has any discretionary authority or discretionary responsibility over the administration of a plan.

Transactional liability

Although individuals can become a fiduciary in two ways—either by taking on a defined fiduciary role or “functionally,” by acting in a fiduciary manner as described above—from a practical standpoint, there is a transactional element that must be considered as well.

A person may be a fiduciary but also act in a non-fiduciary capacity regarding other services to the plan.

Specifically, liability for breaching one’s fiduciary duties only arises when the fiduciary is acting in the capacity of a fiduciary. For example, even though an individual has discretionary authority over the management of a plan, such fiduciary is not liable under ERISA’s fiduciary provisions for actions regarding distributing the plan’s Summary Plan Description since that transaction would not be considered a fiduciary function involving discretionary authority over the management of the plan. The transactional nature of one’s fiduciary status is often explained using the metaphor of a fiduciary wearing his/her fiduciary “hat” at the time of a particular action.

Anyone who exercises discretion or control over the plan can be a fiduciary, regardless of his/her title.

Common fiduciaries

Employer/plan sponsor. Employers who maintain plans, also referred to as plan sponsors, are typically fiduciaries by reason of being named fiduciaries or by assumption of at least one of the fiduciary functions listed above. In such cases, the employer acts in a dual capacity, as both a fiduciary to the plan and as employer. The Department of Labor (DOL) and the courts have recognized that certain functions of an employer are non-fiduciary in nature, so-called “settlor” functions, in that such functions are the

responsibility of the employer, not the plan. For example, the Supreme Court concluded, in *Lockheed v. Spink*, that an employer was not acting as a fiduciary when it amended a pension plan to require a waiver of employment law claims in exchange for enhanced early retirement benefits under the plan.

Other courts have held that an employer may act as a non-fiduciary or settlor when establishing or terminating a plan, or when engaging in corporate actions that might affect the plan. Both scenarios are examples of situations for which the fiduciary is viewed as not making plan decisions but rather making decisions as an employer. In other words, because the decision about whether to have an employee benefit plan is an employer decision, the employer is wearing their “employer” hat, not their fiduciary “hat.”

Corporate officers/board of directors. Corporate officers or members of a board of directors are not fiduciaries simply as a result of their positions at the company. To be considered fiduciaries in their individual capacities, such individuals must have discretionary authority or control with respect to the company’s employee benefit plan. For example, if an individual selects the investment options for the employer’s retirement plan or is responsible for the selection of other plan fiduciaries, then that individual is acting in a fiduciary capacity.

Investment manager/adviser. Investment managers are fiduciaries by definition. ERISA defines an “investment manager” as any fiduciary other than a trustee or named fiduciary who

- Has the power to manage, acquire, or dispose of any asset of a plan;
- Is one of the following types of entities: (i) certain registered investment advisers (including those advisers registered as such under the Investment

Advisers Act of 1940), (ii) certain banks, or (iii) certain insurance companies; and

- Acknowledges his/her fiduciary status, with respect to the plan, in writing.

Even if not an investment manager under this definition, an individual may be a fiduciary because of his/her authority over plan assets or because he/she renders investment advice to the plan. An individual who renders investment advice for a fee is a fiduciary if the following conditions are met: (1) the individual advises the plan as to the value of securities and property for investment of plan assets, or makes recommendations as to the purchasing and selling of such securities; and (2) the individual (a) has discretionary authority on such matters or (b) renders investment advice and such advice serves as the primary basis for investment decisions with respect to plan assets. The courts have found certain brokers, accountants, and even lawyers to be fiduciaries under this definition.

A directed trustee should follow the proper direction of the appropriate plan fiduciary, but only if the direction is made in accordance with the terms of the plan and not contrary to ERISA.

Trustee. With limited exceptions, ERISA requires that all assets be held in trust by one or more trustees. The trustee has exclusive authority to manage plan assets (which is a fiduciary function), except to the extent that the trustee is either (1) subject to the direction of a named fiduciary who is not a trustee, or (2) authority to manage, acquire, or dispose of assets is delegated to one or more investment managers. ERISA requires trustees who are subject to the direction of a named fiduciary (commonly known as a “directed trustee”) to follow the proper directions of such fiduciary

to the extent that the directions are made in accordance with the terms of the plan and not contrary to ERISA. Although there is no definitive guidance on what constitutes “proper” direction, at least one court has concluded that direction that is clear and unequivocal, in writing and from a person or entity with authority to provide such direction, is “proper” direction.

What are plan assets?

Because fiduciaries are often defined by reference to their authority and control over plan assets, determining what assets are plan assets is often the starting point in determining fiduciary status. Although ERISA does not define “plan assets,” DOL regulations and case law provide guidance on the issue. For example, DOL regulations generally define plan assets to

include certain participant contributions, including employee pre-tax and after-tax contributions to retirement plans. Also, when a plan invests in another entity, plan assets generally include the investment vehicle itself but not the underlying assets of the entity. Specifically excluded from plan assets are the underlying assets of a registered investment company (e.g., a mutual fund) and the assets of an insurer that issues a “guaranteed benefit policy” to a plan. Therefore, mutual fund investment managers and issuers of GIC contracts are generally not fiduciaries because they are not managing plan assets. However, investment managers of collective investment trusts or insurance company separate accounts are managing plan assets and are considered fiduciaries.



For ERISA fiduciaries, process and documentation are critical to demonstrating that you engaged in prudent decision making.

Fiduciary duties

As discussed earlier, ERISA establishes four core fiduciary duties, which require plan fiduciaries to do the following:

1. Act prudently
2. Act with loyalty and for the exclusive benefit of participants and beneficiaries
3. Diversify plan investments
4. Carry out plan duties in accordance with the plan's terms and with ERISA provisions

1. Act prudently

ERISA section 404(a)(1)(B) requires a fiduciary to discharge his/her duties with respect to a plan “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 the conduct of an enterprise of a like character and with like aims.”

This standard has come to be known as the “prudent expert” standard. It is generally not enough, under ERISA, for a fiduciary to do his/her best with respect to the plan. The fiduciary, instead, must perform as an expert would or must work with a competent expert. In other words, an “empty head and a good heart” are not enough.

The duty of prudence does not require that every fiduciary decision yield the best possible result. Rather, the courts have focused on the process followed and the documentation available.

In that sense, “prudence” is a two part concept: (1) substantive prudence—having the requisite knowledge and information for a given decision and,

if not, obtaining assistance; and (2) procedural prudence—establishing a process to ensure a consistent approach to decision making and documenting that the process was followed, as well as the substantive analysis performed, each time a decision is made. In *Brock v. Robbins*, the court found that a 10-minute investigation was not prudent for a \$10 million contract involving plan assets. Even without any resulting plan losses, the court granted injunctive relief against the fiduciary. This case underscores a crucial point: plan fiduciaries should be extremely conscientious about creating procedures to govern their actions, following the procedures, and documenting these efforts.

Plan fiduciaries must be familiar with the plan's terms and with ERISA's requirements.

2. Act with loyalty and for the exclusive benefit of participants and beneficiaries

ERISA section 404(a)(1)(A) requires a fiduciary to discharge his/her duties solely in the interest of participants and their beneficiaries for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. This duty is known as the Exclusive Benefit rule.

The Exclusive Benefit rule is perhaps the most complex of ERISA's core fiduciary duties. The complexity arises from the fact that an individual may act in more than one capacity, which inherently implicates the notions of “exclusivity” and “loyalty.” For example, an individual could be a plan fiduciary and could also be an officer of the plan sponsor. In such instances, the individual is wearing more than one “hat.” Because the exclusive benefit rule prohibits an individual from making a fiduciary decision for any purpose other than the

exclusive benefit of participants and their beneficiaries, or the defrayal of reasonable expenses, it is crucial that such an individual understand that he/she is wearing a fiduciary “hat” when making decisions involving the plan. This duty prohibits fiduciaries from making decisions for personal gain. For example, in *Wright v. Nimmons*, the court concluded that a plan fiduciary, who received bank financing for a corporate acquisition in exchange for his moving the corporation’s plan assets to the bank after the acquisition, violated the duty of loyalty. Courts have recognized, however, that corporate officers do not violate their duties if an incidental benefit flows to the corporation after a careful and impartial investigation, and the decision is made focused on the interests of the participants and beneficiaries.

The Exclusive Benefit rule also applies to payment of expenses from plan assets by requiring that fiduciaries discharge their duties for the exclusive purpose of defraying reasonable expenses of administering the plan. Plan fiduciaries typically engage several service providers to facilitate plan administration, including investment professionals, recordkeepers, accountants, trustees, and insurance companies. The investment vehicles selected by the plan fiduciaries often have their own fees that are charged against plan assets. According to the DOL, a plan can pay its own expenses, provided the plan documents do not prohibit it from doing so. Ideally, the plan’s terms should provide for the plan’s payment of appropriate expenses. One common challenge with plan expenses is determining which expenses associated with the plan are plan expenses, as opposed to employer expenses, and whether to allocate such plan expenses among participant accounts.



Fortunately, the DOL has issued guidance regarding what expenses can be paid by the plan, as well as issues relating to allocating such expenses to participants:

- **Settlor vs. Plan Expenses.** In 2001, the DOL issued PWBA Advisory Opinion 2001-01A, which provides guidance, including six examples, explaining the distinction between settlor expenses and plan expenses. This distinction is crucial, since only plan expenses are properly payable by the plan. Settlor expenses are expenses related to the plan but incurred by the settlor, typically the employer, in its capacity as settlor. For example, plan amendments driven purely by plan design considerations, as opposed to tax qualification requirements, are settlor expenses that the plan therefore cannot pay. Plan expenses are expenses related to the plan’s administration, incurred by the fiduciary in its fiduciary capacity. For example, trustee and recordkeeping fees are plan expenses that the plan can pay if the plan’s named fiduciary has determined that such expenses are reasonable.

- Expense allocation in defined contribution plans. According to the DOL and the IRS, neither ERISA nor the Code necessarily prohibits the allocation of plan expenses attributable to participants who are not active employees while the employer pays the corresponding expenses on behalf of active participants who are active employees. Further, if a plan expense, such as the expense of evaluating the qualified status of a domestic relations order, is attributable to a particular participant, it may be permissible for the expense to be allocated solely to that participant's account. The overarching consideration regarding the allocation of expenses is whether the expense allocation is reasonable when taking into account all of the facts and circumstances.

This guidance should govern all allocation decisions, including whether to allocate a particular expense among participant accounts on a per capita or pro rata basis. Further, under the Code, expense allocations must not discriminate in favor of highly compensated employees under Code section 401(a)(4). (Please see *DOL FAB 2003-3* and *Internal Revenue Service Revenue Ruling 2004-10*.)

Another difficulty can be determining whether an expense is "reasonable." According to DOL guidance, fees must be reasonable compensation for "helpful" or "necessary" services. Ultimately, reasonableness is a factual determination. Among the factors a fiduciary may take into account when assessing reasonableness is the value of the services provided. The DOL has noted that the least expensive service provider may not necessarily be the best service provider for the plan. Having a process in place for plan fiduciaries to periodically review the fees and services provided to the plan can assist in demonstrating that fiduciaries acted in a prudent manner in paying plan expenses.

3. Diversify plan investments

ERISA Section 404(a)(1) requires a fiduciary to diversify "the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so."

The diversification requirement cannot be stated in terms of fixed allocation percentages but, instead, depends on the facts and circumstances of each investment, such as each investment's risk and return characteristics and other factors, including the purpose of the plan, the amount of plan assets, and current economic and market conditions.

4. Carry out plan duties in accordance with the plan's terms and with ERISA's provisions

ERISA section 404(a)(1)(D) requires a fiduciary to "discharge his/her duties with respect to a plan... in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with ERISA." This duty requires plan fiduciaries to be familiar with the plan's governing documents and with ERISA's requirements. To the extent that the fiduciary needs expert assistance to determine what those requirements are, the fiduciary must obtain that assistance. It is important to note that, to the extent the plan's governing documents are inconsistent with ERISA, the fiduciary is required to follow the terms of ERISA and, in effect, ignore the inconsistent plan provisions.

The fiduciary remains responsible for selecting and monitoring the investment options in a section 404(c)-compliant plan.

Participant-directed retirement plans—ERISA section 404(c)

Under ERISA section 404(c), fiduciaries can be protected from liability for losses sustained as a result of participants or beneficiaries exercising control over plan assets. The 404(c) requirements are that the plan provides for individual accounts and that participants are permitted to exercise control over assets in their accounts. In addition, the 404(c) regulations outline more detailed requirements, including the disclosure and structural obligations discussed below. While these requirements are substantial and viewed by some as burdensome, what fiduciaries get in exchange—protection from liability related to participant-directed investments—is considered by most to be well worth the effort.

404(c) regulatory requirements

In order for participants and beneficiaries to be viewed as “exercising control” over the assets in their plan accounts, a so-called “404(c) plan” must:

1. **Offer a broad range of investments.** The plan must provide at least three core investment alternatives, each of which is diversified and has materially different risk and return characteristics. When taken together, these options would enable the participant to build a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant.
2. **Permit investment directions at a certain frequency.** The participant must be able to give investment instructions with a frequency that is appropriate in light of market volatility generally applicable to the investment but, in any event, no less frequently than at least once in every three-month period.

3. **Provide certain information to participants.** Before participants have the ability to make investment decisions, they must be provided basic information about the plan, its investment options, and its operations. In addition, additional information about each investment option must be available upon request. Fiduciaries may—and typically do—include required 404(c) disclosures in the plan’s enrollment materials and Summary Plan Description.

Other 404(c) considerations

1. **Duty to monitor investments.** Compliance with 404(c) does not absolve the fiduciary of the duty to prudently select and monitor the investment options available under the plan. Many fiduciaries find that the implementation of a written investment policy is extremely helpful in this regard.
2. **Qualified change in investment options.** The Pension Protection Act of 2006 (PPA) added 404(c)(4) to ERISA which will provide relief to fiduciaries in certain instances when plan investment options are eliminated. The DOL is required to issue regulations, and the provision is effective for plan years beginning after December 31, 2007.
3. **Default investment options.** The PPA also added 404(c)(5) to ERISA, providing relief to fiduciaries when participants or beneficiaries fail to provide investment instructions. If the conditions prescribed by the DOL are satisfied, participants and beneficiaries are deemed to have “exercised control” over their plan assets, despite a lack of direction by participants or beneficiaries.

4. Employee education. Although there is no requirement to provide investment education to plan participants, many fiduciaries believe that it is appropriate to do so. The DOL has issued guidance describing the difference between investment education and investment advice under ERISA. (Please see *Interpretive Bulletin 96-1, 29 CFR section 2509.96-1.*) Employers who choose to provide investment education should follow this guidance carefully to be sure they are not inadvertently giving advice under ERISA, since providing investment advice could subject the employer to potential fiduciary liability.

5. Employer securities. If a plan permits investment in employer securities, 404(c) relief applies to participant direction of investment in employer securities, provided the plan complies with the regulations' specific requirements relating to employer securities. These include that the plan implement procedures designed to protect the confidentiality of participant transactions in employer securities, and that voting and tender rights be passed through to participants.



Plan and trust requirements

Written plan document requirement

ERISA requires that a plan be maintained pursuant to a written document, and spells out some features that the written plan must include. For example, ERISA requires the written plan to specify the basis on which payments are made to and from the plan, and also requires that the written plan describe its amendment procedure.

Trust requirement

ERISA generally requires that plan assets be held in trust. This trust requirement is routinely implicated in the context of participant contributions. Participant contributions, as well as loan repayments, must be deposited into the plan's trust as soon as those assets can be reasonably segregated from the employer's general assets. Although the regulations include an outside deposit limit of the 15th business day of the month following the month in which those contributions are withheld from an employee's pay, this is not a safe harbor. Employers need to make the deposits as soon as administratively practical. The DOL has been extremely active in enforcing this rule through plan audits. The plan's annual report, Form 5500, requires the responsible fiduciary to disclose whether any participant contributions were remitted late to the plan. Employers should avoid potential liability and fines by establishing procedures to ensure timely remittance of these contributions.

Participant contributions and loan repayments must be deposited into a trust as soon as they can be segregated from the employer's general assets.

Reporting and disclosure rules

ERISA imposes numerous reporting and disclosure requirements on plan administrators, requiring plan administrators to provide information to the IRS and the DOL, as well as to plan participants and beneficiaries.

Government reporting requirements

Perhaps the most significant, recurring government reporting requirement applicable to qualified retirement plans is the requirement that plan administrators annually file a Form 5500. The Form 5500 informs the IRS and the DOL on the plan's financial status, as well as on facts about the plan's status under the Code and ERISA. For example, the plan administrator is required to disclose any prohibited transactions that occurred during the plan year on the Form 5500. The Form 5500 is signed by an authorized plan fiduciary under penalties of perjury. The Form 5500 is generally due within 210 days following the close of the plan year, or July 31 for a calendar year plan but can receive an extension of 2 ½ months. Most portions of the filed Forms 5500 are available for public inspection.

Required disclosure to participants and beneficiaries

ERISA requires plan administrators to make several types of disclosures to participants and beneficiaries. The Summary Plan Description requirement is one example. Plan administrators must generally furnish a participant with a Summary Plan Description within

90 days of the time the participant becomes a participant. If a plan is amended, the plan administrator is required to furnish participants, generally within 210 days from the end of the plan year in which the amendment is effective, with a revised Summary Plan Description or a summary of material modifications. These rules also require disclosure to certain beneficiaries.

Another example, recently added by the PPA's amendment of ERISA section 105, is the provision of participant benefit statements. Prior to the PPA, benefits statements were not affirmatively required to be provided and, instead, were to be provided upon written request. Under ERISA section 105, effective for plan years beginning after December 31, 2006, plan administrators must furnish benefit statements to participants at least once each calendar quarter for individual account plans that permit participants to direct their investments (i.e., 404(c) plans), once a year for individual account plans that do not permit participants to direct their investments, and once every three years for defined benefit plans.

Bonding

ERISA section 412 requires individuals who handle plan assets to be covered by a fidelity bond. A fidelity bond is essentially a type of insurance that protects the plan from financial losses due to fraud or dishonesty by those who handle plan assets.

Engaging in a nonexempt prohibited transaction not only violates ERISA, it often creates significant tax liability.



Prohibited transactions under ERISA

In addition to establishing fiduciary duties, ERISA also lists a number of transactions between a plan and a “party in interest” or a fiduciary that are specifically prohibited. These are transactions that lawmakers believed would be most easily subject to abuse if not specifically prohibited.

Party in interest.

A party in interest is almost anyone or any entity having anything to do with the plan, including fiduciaries; employees of the employer maintaining the plan; owners of the employer maintaining the plan; service providers to the plan, including recordkeepers; and generally, anyone related to any of these people or entities.

Party in interest transactions.

Under the prohibited transactions rules, a fiduciary is prohibited from causing a plan to engage in a transaction if the fiduciary knows or should know that the transaction constitutes a direct or indirect

- Sale or exchange, or leasing, of any property between the plan and a party in interest
- Lending of money or other extension of credit between the plan and a party in interest
- Furnishing of goods, services, or facilities between the plan and a party in interest
- Transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan
- Acquisition, on behalf of the plan, of any employer security or employer real property in violation of ERISA

Fiduciary transactions.

In addition, the prohibited transaction provisions prohibit a fiduciary from

- Dealing with the assets of the plan in his/her own interest or for change to his/her own account
- In his/her individual account or in any other capacity acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries
- Receiving any consideration for his/her own personal account from any party dealing with the plan in connection with a transaction involving the assets of the plan

Prohibited transaction exemptions

ERISA’s prohibited transaction rules are so broad that, in the absence of extensive exemptions, many necessary plan operations would likely be impossible. In acknowledgment of this, lawmakers created exemptions, referred to as “statutory exemptions.”

In addition, the DOL has created and continues to create generally applicable exemptions, referred to as “class exemptions,” which cover a broad type of transaction affecting more than a single plan or sponsor, as well as specific exemptions for individuals and entities available upon request, referred to as “individual exemptions.”

- **Statutory exemptions.** ERISA itself lists many exemptions to the prohibited transaction rules. For example, the statutory exemptions include an exemption for participant loans to active employees, contracting for services with recordkeepers, and


providing plan benefits to fiduciaries who are also participants. Generally, the statutory exemptions require that the transaction meet several conditions (for example, in the case of investment advice, the requirements of ERISA section 408(g) must be met) before it will fit within the exemption. A failure to meet any of these will cause the transaction to be a prohibited transaction. Participant loans to employees, for example, must meet all of the statutory exemption provisions or they will be prohibited transactions under ERISA.

- **Class exemptions.** There are several class exemptions, which are authorized by ERISA and granted by the DOL. The class exemptions include an exemption for failure to timely remit participant contributions to the plan, where the contributions are voluntarily restored and the other conditions of the exemption are satisfied. The class exemptions are available at <http://www.dol.gov/ebsa/regs/classexemptions/main.html#section1>.
- **Individual exemptions.** Like the class exemptions, the individual exemptions are authorized by ERISA and granted by the DOL. Individual exemptions are numerous and driven by individual circumstances and concerns, and must be applied for by a plan sponsor (or its authorized representative).

- **Penalties.** Non-exempt retirement plan prohibited transactions can result not only in ERISA liability but also in the assessment of excise taxes under the Code. The Code's rules are not identical to ERISA's rules. Therefore, it is possible for a transaction to be a prohibited transaction under ERISA but not under the Code. Both sets of rules should be consulted if there is any concern that a transaction might be prohibited under either statute.

- **Liability under ERISA.** ERISA requires a full, prompt correction of prohibited transactions. Generally, this means that the plan must be made whole, and the party involved must disgorge any profits resulting from the transaction.

- **Liability under the Code.** The Code imposes a 15% excise tax on "disqualified persons" in connection with prohibited transactions. A disqualified person under the Code is similar to a party in interest under ERISA, although not identical. The amount subject to the tax is the amount involved in the transaction, and the tax can increase rapidly if the transaction is not promptly and appropriately addressed. An individual liable for this tax would use an IRS Form 5330 to report the liability and pay the tax.



ERISA's unique co-fiduciary liability provisions make each fiduciary responsible for the actions of the other plan fiduciaries under certain circumstances.

Consequences of breach of fiduciary duties

Personal liability.

Any fiduciary who breaches ERISA's fiduciary responsibility provisions is personally liable to make good to the plan any losses suffered by the plan and return all profits made through the improper use of plan assets.

Removal of fiduciary.

In appropriate cases, a fiduciary may be removed and permanently prohibited from acting as a fiduciary or providing services to ERISA plans.

Civil penalties.

Among other penalties, the DOL may assess a civil penalty equal to 20% of the amounts recovered for the plan through litigation or settlement.

Criminal prosecution.

Upon a conviction for a willful violation of ERISA's reporting and disclosure requirements, a fiduciary may be subject to fines and imprisonment for not more than one year. A person convicted of embezzlement or conversion of plan assets (see *United States v. Grizzle*) may be fined or imprisoned for up to five years. Among other things, this provision has been used to prosecute employers who withheld participant contributions from participant paychecks, did not remit them to the plan, and used them for the employer's own purposes.

Co-fiduciary liability.

A fiduciary may also be liable for the breach of another plan fiduciary. ERISA provides for co-fiduciary liability when a fiduciary

- Knowingly participates in or knowingly conceals the breach of another fiduciary;
- Enables another fiduciary to commit a breach through his/her own failure to comply with the fiduciary rules; or
- Has knowledge of another's breach and fails to make reasonable efforts to remedy the breach.

Voluntary fiduciary correction program (VFCP).

This is a DOL program that allows affected individuals to voluntarily correct certain ERISA fiduciary duty violations, although the DOL must approve the correction. If approved, it permits the fiduciary to avoid civil ERISA penalties.

The VFCP provides for the correction of certain types of violations:

- Delinquent participant contributions to retirement plans
- Certain violations involving plan loans
- Certain violations involving the purchase, sale, and exchange of property when a plan is a party to the transaction
- Payment of benefits without proper valuation of the plan assets on which the payment is based
- Certain violations involving the plan's payment of expenses

▶ Section 2: Strategies for limiting liability

Following these strategies could potentially limit fiduciary liability.

Process and documentation

There is a significant amount of case law indicating that a fiduciary is not to be judged in hindsight. In other words, whether the fiduciary made the “right” decision is not dispositive of whether fiduciary liability will be imposed. Instead, the determination of whether a fiduciary has violated ERISA focuses on whether the decision was the result of a prudent decision-making process. Accordingly, a simple yet powerful way to mitigate fiduciary risk is to establish and follow decision-making procedures and document the steps and reasoning underlying decisions (i.e., substantive and procedural prudence). Along those lines, to the extent the fiduciary relied on information and advice from others, documentation is critical to establishing the qualifications of such expert, the substance of the advice, and the scope for which the expert was consulted.

Compliance with ERISA section 404(c)

Many 401(k), profit sharing, and other defined contribution plans allow participants to choose their own investments from a menu of investment options selected by the employer or other plan fiduciary. In this situation, employers should consider compliance with ERISA section 404(c) in order to limit their liability for investment decisions made by the participants. As explained in detail in Section I, compliance with section 404(c) requires that participants be given an opportunity to exercise control over the assets in their individual accounts at an appropriate frequency and to choose from a broad range of investment options.

The employer or other plan fiduciary remains responsible for selecting and monitoring the investment options that are made available to participants.

Delegation of fiduciary responsibilities

Named fiduciaries are not necessarily responsible for all fiduciary duties. The plan may permit a named fiduciary to allocate duties among other named fiduciaries or delegate fiduciary duties to someone other than a named fiduciary. For example, the named fiduciary may appoint an investment manager, claims administrator, or other fiduciary. This does not transfer or eliminate all of the named fiduciary’s responsibilities. The selection, appointment, and monitoring of other fiduciaries are themselves fiduciary functions, so the appointing fiduciary remains a fiduciary for those purposes.

Plan fiduciaries must follow proper procedures (including ongoing monitoring) to effectively delegate responsibility to co-fiduciaries.



However, if the appointing fiduciary follows the plan's terms, exercises prudence in the delegation process, and then properly monitors the fiduciaries it appoints, the named fiduciary will be likely protected from liability for any negligent acts of such delegates.

Appointing an investment manager.

As previously mentioned in the "Co-fiduciary liability" discussion on page 15, a fiduciary may be liable for the breach of another fiduciary. However, section 405(d)(1) of ERISA limits the circumstances under which trustees and other fiduciaries would be liable under ERISA's co-fiduciary liability provision for fiduciary breaches of an investment manager. Presuming that the appointing fiduciary meets its responsibilities for selection and monitoring of the investment manager, they would not be liable for the individual decisions made by the investment manager. The PPA provides similar relief for the appointment of fiduciaries who provide investment advice as long as certain conditions are met.

Duty to prudently select co-fiduciary.

In selecting a fiduciary, the appointing fiduciary must act prudently and for the exclusive benefit of plan participants. He/she must undertake a due diligence process in the selection, and cannot be influenced by factors other than what is in the best interest of participants.

The due diligence process may vary depending on the fiduciary position being considered. A typical review would consider such items as the experience and historical performance of the fiduciary, the financial stability and compensation of the fiduciary, and the relationship of the fiduciary with other parties to screen out any potential conflicts of interest.

Duty to monitor.

Prudence requires the appointing fiduciary to regularly monitor the activities and performance of the appointed fiduciary in order to determine if the delegation should continue. It may become necessary to remove the fiduciary or take other remedial action. The nature of this monitoring and review depends on the duty delegated to the appointed fiduciary. For example, a named fiduciary who appoints an investment manager would periodically review the investment manager's performance and determine if the investment manager is following the investment policy.

Selection and monitoring of service providers

Plan fiduciaries should also follow a due diligence process in hiring and retaining service providers. They must make decisions regarding plan service providers that are solely in the best interest of the plan. Plan fiduciaries should therefore choose the plan service providers that they conclude, after diligent investigation, will be best for the plan overall, not necessarily the least expensive. Other considerations should not interfere with the selection of the best service providers. For example, a corporate officer who is also a plan fiduciary would commit a prohibited transaction if he/she selected a plan service provider, for example, a bank that also serves as a third party administrator, because the bank agreed to provide the employer with a reduced interest rate on a line of credit as a reward for choosing the bank as the plan service provider.

Fiduciaries are also obligated to ensure that the fees paid by the plan to service providers are reasonable and necessary. This obligation applies not only when the fiduciary is selecting the service provider but on an ongoing basis as well.

Given the disparity in the manner in which service providers present their fees, comparing them to each other can be difficult. To assist fiduciaries in sorting out fees, the DOL has developed the 401(k) Plan Fee Disclosure Form, available at <http://www.dol.gov/ebsa/pdf/401kfefm.pdf>.

Education and guidance of plan participants

Although there is no specific statutory duty to provide financial or investment education to participants, many employers believe that it is appropriate to do so in order to help prepare participants to make informed decisions. Providing general investment education does not make the employer a fiduciary for this purpose as long as the guidelines of the DOL Interpretive Bulletin 96-1 are followed. However, the hiring of an individual or entity to provide such education is a fiduciary act. Therefore, the employer should follow the same prudent process it follows in hiring and monitoring any other service provider.



▶ Section 3: Fiduciary duty for non-ERISA plans

Certain plans and employers are exempt from ERISA's fiduciary provisions. This section identifies which types of employers or plans are exempt from ERISA and summarizes the fiduciary responsibilities that may arise under state laws.

Who are non-ERISA employers and plans

ERISA exempts all governmental employers and plans from ERISA fiduciary responsibilities. Church sponsored retirement plans are generally non-ERISA, but the plan sponsor is allowed to "elect" ERISA coverage under the Internal Revenue Code. If an ERISA election is made, the ERISA requirements under both the Internal Revenue Code of 1986, as amended, and Title I of ERISA, which includes the fiduciary provisions, will apply to the plan. Finally, section 403(b) plans are exempt from ERISA's fiduciary provisions if the plan allows only voluntary employee contributions and the employer's involvement in plan administration is limited to certain types of administrative functions permitted under DOL regulations.

Fiduciary duties of non-ERISA plan sponsors

Being exempt from ERISA's fiduciary duties does not mean that a plan sponsor has no fiduciary duties. Non-ERISA plan sponsors must look to state laws for the fiduciary rules that apply to them. The fiduciary law might be in court cases or in state statutes. The state statutes can be general in nature yet apply to retirement plan sponsors. An example of this type

of law is the Uniform Prudent Investor Act, which has been adopted in a majority of states. Some states have fiduciary responsibility laws that apply only to certain employers or plans, such as schools. In some states these laws are very similar to portions of ERISA, and sometimes they are actually identical to portions of ERISA, or they incorporate portions of ERISA by reference. For example, California has amended its Education Code to include ERISA's prudent man rule. Indeed, the wording of California Education Code section 22250 is essentially identical to that of ERISA section 404(a). Most of these state laws focus on defining a prudent investment and do not include the ERISA section 404(c) provisions for participant-directed accounts. However, the Uniform Management of Public Employee Retirement Systems Act, adopted in just a few states, includes protections similar to ERISA section 404(c) and other ERISA provisions.

Fiduciaries of non-ERISA plans should become familiar with the applicable laws of their state. In addition, they may also look to the ERISA laws, regulations, and court cases as helpful resources, even though they may not apply directly as a matter of law. The ERISA regulatory environment is a major influence in defining the necessary level of "care, skill, prudence, and diligence under the circumstances then prevailing" (as articulated by ERISA jurisprudence). A non-ERISA fiduciary can benefit from understanding ERISA and adopting ERISA's provisions where appropriate and useful.

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