Advising 401(k) plans: Are you acting as an ERISA Fiduciary?

Ed Barkel
Partner, Lewis and Roca LLP

Many brokers enter the 401(k) plan market because systematic contributions translate into a steady stream of fees or commissions. Unfortunately, as usual, there is no free lunch. Providing investment services to employee retirement plans may trigger added duties and risks above and beyond the duties and risks associated with FINRA and SEC rules. The duties, and associated risks, are imposed by the Employee Retirement Income Security Act ("ERISA") and extensive regulations adopted by the Department of Labor to implement the Act.[1]

To gain a marketing advantage some advisors and brokers willingly or inadvertently become plan fiduciaries assuming personal liability imposed by ERISA. For example, some advisors and brokers solicit 401(k) plan business by offering to act as the plan's "Investment Manager" thereby relieving the 401(k) plan's named fiduciaries of responsibility and liability for the management of the 401(k) plan's investments. More frequently, advisors and brokers who are not permitted by their firms or their errors and omissions policy to act as an ERISA fiduciary inadvertently assume shared fiduciary responsibility and liability based upon their actions.

Providing investment services to 401(k) plans is not without pitfalls. However, if one understands how the services provided fit into the regulatory framework, the assumption of fiduciary responsibilities and liability can be avoided.

The ERISA Framework and Fiduciary Liability

ERISA requires that the plan document name certain fiduciaries who are responsible for the control, operation, administration and management of the plan. The named fiduciaries often include the plan administrator and plan sponsor. Other fiduciaries include trustees and third parties designated by the named plan fiduciaries to operate and manage the plan.

There are four general rules those acting as a plan fiduciary must follow. They are: (i) the exclusive benefit rule (act for the benefit of plan participants); (ii) the prudent man rule (do what a prudent professional would do); (iii) diversification rule (provide diversified investment options); and (iv) the plan document rule (follow the plan's documents including Investment Policy Statement).[2] ERISA Rules also restrict self-dealing and similar "prohibited transactions," which present a high likelihood that plan assets will be misused.

Anyone who qualifies as a "fiduciary" to a plan, by regulation, agreement or conduct is subject to personal liability for losses incurred by the plan arising out of a breach of his or her fiduciary duties.[3] If a breach is shown, the fiduciary must make the plan whole by restoring losses incurred and disgorging profits made through the use of plan assets.[4] Civil actions to enforce ERISA liability may be brought by any participant, co-fiduciary or the U.S. Department of Labor.[5]

Named plan fiduciaries frequently seek to limit or shift liability for investment losses by allocating some or all of their duties related to the selection and management of plan investments to those providing investment advice or to plan participants through self-directed investment portfolios.[6] To avoid liability the named fiduciaries must be able to demonstrate that they were diligent and acted prudently in the selection of investment professionals, the investments selected for participants and the performance of the investments.[7]

Financial Professionals May Be Deemed to Be ERISA Fiduciaries

Financial professionals considered fiduciaries under ERISA fall into two classes: (i) designated "Investment Managers," *e.g.* a Section 3(38) Fiduciary, and (ii) other individuals who are deemed to be fiduciaries based upon their conduct, *e.g.* a Section 3(21) Fiduciary.

A Section 3(38) Investment Manager must enter into a written agreement with the plan accepting fiduciary responsibility. ERISA limits those who qualify to serve as an Investment Manager under Section 3(38) to a bank, an insurance company or a registered investment advisor subject to the Investment Advisors Act of 1940. As a result, it would be improper for an individual broker, to hold him or herself out to a plan as an "Investment Manager".

Individuals and entities who do not qualify as an Investment Manager may, based upon their conduct, be deemed to be a fiduciary under Section 3(38). A person will be deemed to be a fiduciary for any of the following reasons:

- exercising any discretionary authority or control over the management of the plan or its assets;[8]
- rendering regular investment advice to a plan for a fee;[9]
- representing that the individual will assume fiduciary responsibility for the plan's investments;[10]
- rendering any advice ... on a regular basis to the plan pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between the person and the plan; *Id.*
- providing services that will serve as a primary basis for investment decisions with respect to plan assets; *Id.*

continued

- rendering individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments; *Id.* and
- making all investment decisions for a plan over a lengthy period of time.[11]

Many Services Do Not Create Fiduciary Liability

Do not lose hope. The mere rendering of investment services to a 401(k) plan will not automatically create fiduciary liability for a financial professional. DOL regulations state that individuals and entities which provide professional services in the form of consulting or ministerial services are not considered fiduciaries, unless they have discretionary authority or responsibility with respect to a plan or its assets.[12] The DOL regulations seek to distinguish fiduciaries from "persons who have no power to make any decisions as to plan policy, interpretations, practices or procedures" who perform certain administrative functions "within a framework of policies, interpretations, rules, practices and procedures made by others, fiduciaries with respect to the plan." Brokers frequently provide services which are deemed "purely ministerial functions" including:[13]

- preparation of employee communications material;
- orientation of new participants and advising participants of their rights and options under the plan;
- collection of contributions and application of contributions as provided in the plan;
- preparation of reports concerning participants' benefits;
- processing of claims; and
- making recommendations to others for decisions with respect to plan administration.

The Careful Delivery of Investment Services Can Limit Exposure to Fiduciary Liability

As long as a broker limits the scope of the services provided, the marketing packaged 401(k) plans should not trigger fiduciary responsibility. In general, the courts have held that the services provided by a broker selling packaged products to a plan will not be considered "individualized advice" triggering ERISA liability, even if individual attention is focused on plan participants.[14] For example, one court held that providing portfolio summaries to individual employees did not constitute individualized advice, but instead was only a sales tool to promote customer loyalty. *Id.*

Courts have often emphasized that fiduciary status requires formal and final decision-making power over investments by the financial professional, as opposed to mere salesmanship.[15] For example, a brokerage firm did not exercise any control over investments when it selected certain securities to recommend to the plan trustees for their final selection and approval. The court considered the recommendation to be part of a sales pitch to match the customer's desires with the broker's inventory rather than an exercise of control by the broker over the plan assets.

Conclusion

Marketing to 401(k) plans need not open the door to onerous ERISA liability. Following some simple do's and don'ts will help avoid unwanted risk:

- do state in writing that you are not acting as a fiduciary;
- do delineate the limited investment services you will provide, and those you will not provide;
- do provide diversified investment options;
- do leave all final decisions to the plan's fiduciary;
- do not act with discretion;
- do not take control of plan assets;
- do not provide individualized investment advice; and
- do not provide specific recommendations regarding the purchase of individual investments.

---

1 Congress adopted ERISA in 1974. 29 U.S.C. §§ 1001-1461, as amended.
2 29 U.S.C. §1104 (a)(1)(A)-(D)
3 ERISA §409(a)
4 29 U.S.C. §1109.
5 *Larue v. DeWolff, Boberg & Associates*, 200 U.S. 321
6 ERISA §404(c)
7 29 U.S.C. §1105 (c).
8 29 U.S.C. §1002 (21)(A).
9 Id.
10 29 C.F.R.§ 2510.3-21(c) Thomas, Head, & Greisen Employees Trust v. Buster, 24 F.3d 1114,1116-20 (9th Cir. 1994)
11 *Meyer v. Berkshire Life Insurance*, 372 F.3d 26 (4th Cir. 2004)
12 29 C.F.R. §2509. 75.5.
13 *See* Questions and Answers Relating to Fiduciary Responsibility under the Employee Retirement Income Security Act of 1974, 29 C.F.R. § 2509.75-8 (2011).
14 *Farm King Supply, Inc. Integrated Profit Sharing Plan & Trust v. Edward D. Jones & Co.*, 884 F.2d 288 (7th Cir. 1989)
15 *Schloegel v. Bosswell*, 994 F.2d 266

Comments suggestions or inquiries are welcome and should be directed to: mary.pat.fischer@aon.com

Aon Risk Services Northeast, Inc.
199 Water Street New York, NY 10038 • (800) 243-5117

Mr. Barkel is a partner with the law firm Lewis and Roca and a member of the firm's Securities Litigation practice group. Mr. Barkel defends broker-dealers and individual brokers in arbitrations and litigated matters. He also provides consulting services in compliance-related matters including supervisory system design, special investigations, special supervision programs, branch office examinations and regulatory mandated consulting. Before joining Lewis and Roca in 2002, Mr. Barkel worked for 8 years in the securities industry, both as counsel to broker-dealer firms and as a registered rep.

X-10096-0113