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An Employer Checklist of 401(k) Plan Responsibilities Under ERISA

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May 26, 2010

The Legal Intelligencer

Though the past several years have been fraught with peril for the economy and risk in stock markets, employers continue to provide employees with the opportunity to invest money for retirement through an employer-sponsored retirement plan. The most common of these is the 401(k) plan.

An October 2009 study presented by the U.S. Government Accountability Office indicates that of the 49 million workers who participate in defined contribution plans, 85 percent participate in a 401(k) plan.

Along with the benefits of providing a plan comes legal responsibility for the employer that sponsors it. Employers are not required to sponsor retirement plans. However, once an employer offers a retirement plan to its employees, the plan is subject to potential civil and criminal liability under both the Employee Retirement Income Security Act of 1974, or ERISA, and the Internal Revenue Code.

Legal counsel can assist the employer sponsoring a 401(k) plan in avoiding or minimizing legal liability related to the plan by conducting a "checkup" of a plan's current operations and documentation.

The Employer as ERISA Fiduciary

As plan sponsor, an employer must ensure that those considered ERISA "fiduciaries" fulfill their responsibilities. An ERISA fiduciary is any person who: exercises discretionary authority or control over management of the plan or its assets; renders investment advice for direct or indirect compensation with respect to plan assets, or has authority or responsibility to do so; or has discretionary authority or responsibility in administering the plan. The employer is most often a fiduciary in its roles as the plan sponsor and plan administrator.

- Plan Sponsor: Decisions of the plan sponsor, such as designing and amending a plan, are business decisions, not fiduciary ones. Nonetheless, other decisions are fiduciary in nature, including selecting funds available under a plan and/or deciding to hire a third-party to provide investment management services, recordkeeping services, plan education or trustee services.
- Plan Administrator: The plan administrator is responsible for the day-to-day administration of the plan, including complying with ERISA's reporting and disclosure requirements; maintaining plan records; and routine tasks such as processing election forms distribution requests including hardship withdrawals and loans.
- Named Fiduciary: Each plan must have a "named fiduciary," a party named in the plan document with the authority to manage and control the plan's operation and supervise all other fiduciaries. Unless the authority to do so is otherwise delegated, the named fiduciary is responsible for the selection and monitoring of plan investments.

Requirements of the ERISA Fiduciary

- Duty of loyalty: An employer must display a duty of loyalty by carrying out his or her fiduciary duties for the exclusive purpose of providing benefits to participants and beneficiaries and defraying the reasonable expenses of plan administration. Although a corporate officer may also serve as a fiduciary, the duty of loyalty requires that a "dual capacity fiduciary" consider only the interests of participants and beneficiaries as such when making decisions regarding the plan.

An employer should take the following steps to demonstrate this duty of loyalty:

- Scrutinize conflicts of interest to ensure that they are not adversely affecting a fiduciary decision. A fiduciary operating under a conflict may prefer to excuse himself from participating in the decision.
- Ensure administrative expenses paid by the plan are reasonable. The most inexpensive services need not be utilized, but fees must reasonably reflect the services rendered.
- Duty of prudence: An employer must act with the care, skill, prudence and diligence that a person 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.

An employer is required to undertake an independent investigation into the merits of an investment decision, including comparable alternatives. Once such decisions are made, the fiduciary must continue to monitor investment performance and alter available plan investments if circumstances change or if an investment alternative's performance targets are not met. If a fiduciary is ill-equipped to evaluate the merits of a proposed investment, the fiduciary should seek independent, qualified assistance, such as from a third-party investment adviser.

Documentation is an essential component of prudence and should include the following:

- The merits of the proposed investment: Take minutes of meetings where the investment is considered and retain copies of reports, analysis and opinions.
- The final decision regarding the proposed investment: Reflect the final conclusion justifying the decision.
- Contractual relationships: Enter into written agreements accurately describing the parties' obligations, including an effective delegation of fiduciary responsibility if needed, regular reporting, indemnification and reasonable termination provisions. "Form" agreements offered by service providers are almost always very one-sided in favor of the service provider, and therefore should be reviewed by counsel before signing in light of the requirements discussed in this article.
- Duty to Diversify: The employer must diversify plan investments so as to minimize the risk of large losses to participants, unless it is clearly prudent not to do so. A fiduciary who fails to diversify the plan's investments bears the burden of providing that not doing so was prudent. When contemplating and undertaking the duty to diversify plan investments, a fiduciary should do the following:
- Consider facts and circumstances that the fiduciary should know are relevant to the performance of investments.
- Document process regarding investment selection.
- Solicit input from an investment adviser or investment consultant, if necessary.

The fiduciary should also develop and adopt a written investment policy, which is intended to assist a plan's fiduciaries in making investment-related decisions prudently. The investment policy also outlines the underlying philosophies and processes for the selection, monitoring, and evaluation of the investment options utilized by the plan. It should include various elements, including but not limited to:

- The objectives for structuring a retirement investment program suitable to the long-term needs and risk tolerances of each plan participant.
- The roles of those responsible for the investment of the plan's assets.
- Appropriate diversification within investment vehicles.
- The criteria and procedures for selecting investment options.
- Ways to address investment options that fail to satisfy objectives.
- Objectives for prudently monitoring and evaluating investment procedures, measurement standards and monitoring procedures.
- A foundation for participant investment education and communication.

An investment policy should be amended to reflect changes in the capital markets, plan participant objectives or other relevant factors. Moreover, a plan sponsor should review the plan document and summary plan description periodically to ensure that the investment policy does not conflict with the terms of these documents.

- Duty to Monitor: An employer also has a duty to monitor prior decisions to ensure that a prudent decision remains prudent over time. If circumstances change or if performance targets are not met, it may be prudent to make a change.
- Duty to Follow Plan Documents: A fiduciary should follow the terms of the plan documents as long as they comply with ERISA. Only in extreme cases, where it is clearly imprudent to follow the terms of the plan documents, may a fiduciary ignore those terms.

Participant-Directed Investment

An employer may also opt for protections under Section 404(c) of ERISA, which provides that the participant will not be deemed a fiduciary and fiduciaries will not be liable for any loss caused by the participant's directions under certain circumstances. The provision applies if the plan provides for an individual account for each plan participant and if it permits each participant to direct the manner in which his or her account balance will be invested by selecting from among a broad range of investment alternatives.

Section 404(c) requires that certain information about investment options be provided, and rules concerning the ability to change investment directions be followed. For example, a plan must provide an explanation that it is intended to be an ERISA Section 404(c) plan and that plan fiduciaries may be relieved of liability for losses resulting from participant direction, as well as a description of the investment alternatives available under the plan, including their investment objectives and risk and return characteristics. The decision to implement ERISA section 404(c) protections does not relieve an employer of all potential fiduciary liabilities, however.

ERISA Liability

A fiduciary may be held personally liable for losses caused by his or her breach of ERISA, as well as for another fiduciary's conduct. Such co-fiduciary liability may apply where a fiduciary knowingly participates in or knowingly conceals an act or omission of another fiduciary knowing that such act or omission constitutes a breach. In addition, liability may be incurred if, through a failure to satisfy his own fiduciary duties, a fiduciary "enables" another fiduciary to commit a breach. Thus, a fiduciary may not claim ignorance of fiduciary conduct within his oversight responsibility.

If a fiduciary has knowledge of another fiduciary's breach, he or she may be held personally liable unless he makes reasonable efforts to remedy the breach. Reasonable efforts could entail: reversing a transaction; informally obtaining restitution; establishing procedures to ensure such conduct does not recur; terminating an appointment; taking formal legal action or reporting the conduct to appropriate regulatory authorities.

Internal Revenue Code Liability

An employer may also develop liabilities related to the plan under the Internal Revenue Code. The requirements for a 401(k) plan under the code range from technical testing mandates, such as not discriminating in favor of those employees considered to be "highly compensated," to failures to follow the terms of the plan document. The latter failure is the easiest to remedy through periodic plan audits.

If an employer finds a mistake during a self-audit of a plan, mistakes may be eligible to be corrected under the IRS Employee Plans Compliance Resolution System (EPCRS). Such errors, if later picked up during an IRS audit, could expose the employer to monetary penalties, in addition to related legal fees.

Generally, the nondiscrimination tests applicable to 401(k) plans are the minimum coverage test, the actual deferral percentage test, the actual contribution percentage test and the top-heavy test.

If nondiscrimination tests are not satisfied, a correction must be made. For instance, where a plan fails to pass the ADP or ACP test, one correction under the IRS EPCRS requires the plan sponsor to make a contribution to the plan to raise the average contribution by a "non-highly compensated employee" by the end of the plan year following the plan year in which the test is failed.

The technical nature of compliance with ERISA and the code often requires an employer that sponsors a 401(k) plan to seek guidance from legal counsel. Nonetheless, there are simple steps that an employer may take to increase compliance with both of these laws, including the following:

- Review plan documents: Review the plan document and summary plan description to ensure that the terms are consistent with plan operations, and that the terms of the plan document and summary plan description are consistent with one another.
- Implement and maintain proper plan investment oversight: Appoint/maintain a plan investment committee, hold and document regular meetings of this group, and develop and comply with a written investment policy.
- Perform initial and ongoing due diligence on plan service provider fees: Document the process regarding the selection and continued engagement of any service providers, including the determination that fees charged are reasonable now and in the future.
- Document the fiduciary decision-making process: Take minutes of all meetings where investments or service provider selection are considered, retain copies of reports, analysis and opinions and the basis for conclusion for selecting, retaining or modifying investment options or service providers.

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