

Understanding your fiduciary responsibilities for retirement plans

An overview of the fiduciary's role and frequently asked questions about it

When you are a trustee or serve on an investment committee of a qualified plan governed by the Employee Retirement Income Security Act (ERISA), you are considered a fiduciary and accept responsibility to preserve the assets entrusted to you on the behalf of the plan participants and beneficiaries you represent.

The legal requirements expected of most fiduciaries are, in many ways, the same as those of prudent investment professionals. In other words, fiduciaries are expected to make fund-management decisions with the same professionalism as a prudent expert.

ERISA and its impact

ERISA is the federal law that outlines the fiduciary's role and responsibilities. ERISA regulates and sets standards for employer-sponsored benefit plans to protect the interests of the participants by:

- Requiring the disclosure of fees and other information to participants and their beneficiaries.
- Establishing standards of conduct, responsibility, and obligations for employee benefit plan fiduciaries, including identifying prohibited sanctions.
- Providing participants and their beneficiaries with appropriate remedies and sanctions and ready access to the federal courts.

ERISA's standard of fiduciary conduct applies to most employee benefit plans, including:

- Pension/cash balance plans (defined benefit)
- Profit-sharing/401(k)/money purchase plans (defined contribution)
- Thrift and savings plans
- Stock bonus programs
- Taft-Hartley plans
- Most employee-welfare benefit plans

ERISA is the guiding authority and comprehensive source that sets the parameters under which a fiduciary functions.

What is a fiduciary?

A fiduciary is a person or entity who:

- Exercises discretionary authority or control over the plan's management
- Exercises authority or control over the management or disposition of the plan's assets
- Renders investment advice for a fee or other compensation with respect to plan funds or property
- Has discretionary authority or responsibility over the plan's administration

Who can be a fiduciary?

A fiduciary is a person, company, or association that acts in a capacity of trust and is therefore held to higher standards with respect to plan-related actions.

A fiduciary can be an entity that holds in trust such assets as qualified retirement plans, endowments, and other institutional investments. An investment fiduciary is responsible for investing the money wisely for the beneficiary's benefit.

Trustees of retirement plans and board members of foundations are commonly recognized as fiduciaries; however, business owners, company presidents, principal shareholders, corporate officers, and corporate trustees of institutional funds may also have fiduciary status.

Identifying fiduciaries

ERISA's guidelines for identifying fiduciaries are based on function with respect to the plan. Certain positions generally associated with fiduciary responsibility are:

- Plan administrators
- Administrative committees
- Plan trustees
- Named fiduciaries [e.g., officers, investment advisors (plan's private money manager)]

Generally, you are a fiduciary if you control plan assets or render investment advice for a fee. Some fiduciaries are fiduciaries only for certain actions, such as selecting investment managers for the plan.

What is a fiduciary's role?

General standards of conduct under ERISA

There are five general standards of fiduciary conduct under ERISA. The fiduciary is responsible for ensuring that:

- Employee benefit plans exist solely to serve the interests of the participants and beneficiaries.
- The funds inside employee benefit plans are used only to provide benefits to participants and their beneficiaries and to defray reasonable plan-administration expenses.
- Employee benefit plans are discharged in accordance with written instruments and documents that should include investment objectives. Fiduciaries have the right to rely on professionals to help them through this process.

- Investment duties are fulfilled with the care, skill, prudence, and diligence of an expert familiar with such matters. Fiduciaries must consider all the facts and circumstances that are relevant to the plan's investment objectives.
- Investments are diversified to minimize the risk of large losses unless it is clearly prudent not to do so under the circumstances.

Delegating authority as a fiduciary

Under ERISA, delegating authority is allowed and should be done when the duties required are beyond the named fiduciary's knowledge, expertise, experience, or resources. However, delegating such authority does not completely release the fiduciary from liability—it is a delegation of function, not of responsibility. The fiduciary is accountable for its choice of delegates and can still be held accountable for actions taken by those to whom authority was delegated.

Some of the more common functions that are delegated fully or in part include:

- **Named fiduciary as defined under ERISA section 3(16)**—The person named in the plan document as the plan administrator is responsible for the oversight of the operation of the plan. This should not be confused with pension administrator or third-party administrator. Some of the plan administrator's responsibilities include timely filings with the federal government (Form 5500, etc.), distributing disclosures to plan participants, hiring plan service providers, and fulfilling other responsibilities as set forth in the plan documents.
- **Trustee**—The designated person or entity with authority over the plan assets as defined under ERISA section 3(21). When hiring a corporate trustee, you can delegate the oversight of the assets, commonly referred to as a directed trustee, or you can delegate full discretion of the management and control of the plan assets, commonly referred to as discretionary trustee.
- **Investment advisor**—For the purpose of this publication, an investment advisor is a person as defined under ERISA section 3(21) who may:
 - Provide investment advice to participants or other fiduciaries in connection with plan assets.
 - Serve in an advisory capacity only (leaving final decisions to another fiduciary). "Advisory" fiduciaries are sometimes known as "limited scope" fiduciaries, or more commonly referred to as someone who provides

investment recommendations. In either case, the employer still decides to accept or decline the recommendation provided by the hired investment advisor and is still a fiduciary. An agreement is typically executed between the employer and the 3(21) fiduciary.

- **Investment manager as defined under ERISA**

section 3(38)—A 3(38) fiduciary is anyone other than a named fiduciary or trustee who has full discretion and control for investment selection, monitoring, and replacement. The presence of a 3(38) fiduciary relieves the employer from fiduciary liability for the investment selection, monitoring, and replacement. The plan sponsor is, however, still liable for the prudent selection and monitoring of the 3(38) fiduciary. Keep in mind when hiring a 3(38) fiduciary, the investment committee or other named fiduciary loses control of the ability to make any investment decisions. A 3(38) fiduciary must typically be a bank, insurance company, or registered investment advisor (RIA). An agreement should be executed between the employer and 3(38) fiduciary.

Who is not a fiduciary?

Conversely, certain functions are not associated with fiduciary responsibility. Generally, entities acting in the normal course of their primary business and that do not have any discretionary control over plan assets are not considered fiduciaries.

Other examples of those not considered fiduciaries include attorneys, accountants, actuaries, participants, service providers whose functions are not more than ministerial, and individuals who perform administrative functions but are unable to make plan decisions.

The following functions can be performed without being a fiduciary:

- Applying rules determining eligibility for participation and benefits
- Maintaining participant records
- Calculating benefits
- Allocating contributions according to the plan document
- Preparing government-agency reports
- Processing claims

Bonding requirements

Because the fiduciary's role carries such importance and responsibility, ERISA requires that most fiduciaries and those who handle a plan's funds or property of the plan be bonded.

These bonds reimburse the plan for up to the coverage amount and are necessary to protect the plan and the plan's beneficiaries against losses due to wrongful acts by the fiduciary. Though the plan is protected, the insurance does not protect the fiduciary from liability claims.

A fiduciary insurance policy:

- Should define wrongful acts.
- Should include a severability clause to prevent dishonesty of one fiduciary.
- Must include a waiver of recourse provision if personally covering fiduciaries (the waiver's premium cannot be paid out of plan assets).

To help in the selection of a fiduciary insurance policy, certain things should be considered:

- Check that the deductible applies to a single act, or interrelated acts, rather than one claim for each act.
- Consider buying a separate policy for defense costs, or adding a "defense outside the limit of liability" endorsement to the policy, to ensure greater protection.
- Check the policy for defense costs for allegations of discrimination and other claims generally excluded from indemnity coverage.
- Consider an endorsement to pay Department of Labor (DOL) or IRS penalties, fines, taxes, or sanctions levied for breach of fiduciary responsibility.

Explaining service provider fees and expenses

Another aspect of fiduciary responsibility is to be aware of exactly what fees and expenses are being charged against a participant's accounts and to the plan. The fiduciary must determine the plan fees are reasonable based on the services provided. Having documentation of the due diligence process is an important part of this responsibility as it can help protect the fiduciary against liability.

As a testament to the importance of understanding all fees associated with your plan, the DOL has imposed regulations to ensure the plan sponsor's and participants' (when permitted to make investment decisions) awareness of all

plan related fees and expenses by requiring additional notices. As a plan sponsor, it is your fiduciary duty to know and understand all the retirement plan fees and ensure that those fees are reasonable.

Investment policy statements

To help document that you are meeting your fiduciary responsibilities, ERISA encourages fiduciaries to have an investment policy statement. Though not required, this written policy establishes the objectives and criteria for managing the investments that fund the plan.

In essence, it guides the plan and protects the fiduciary by documenting how decisions are made as it relates to the plan's investments, which is especially helpful in times of volatile markets.

Monitoring the performance of investment alternatives is an important part of any investment policy statement. Fiduciaries should compare the plan's investment performance to appropriate market indexes (benchmarks) at least annually to determine the appropriateness of the plan's investments given market conditions.

Even if you decide to maintain your current choices and/or allocation, it is important to document your monitoring efforts and the reasons supporting the decision.

The Profit Sharing/401(k) Council of America recommends the following general provisions be included in an investment policy:

- A mission statement outlining the plan's investment objectives and goals.
- A declaration stating that those involved with the administration and management of plan assets are expected to adhere to professional fiduciary standards.
- A clause indicating whether the plan is intended to comply with ERISA 404(c).
- A statement on the purpose of the investment policy statement and the plan's processes for selecting, monitoring, and evaluating plan investments.
- A list of the roles of those involved with plan investments and a summary of their responsibilities. (For investment committees, identify the composition and scope of role.)
- Monitoring procedures, how managers should report performance, and a review schedule.
- Guidelines for replacing plan investments and investment managers.

- A statement that, should conflict arise, the plan document provisions have precedence over investment policy provisions.

Selecting and monitoring investments

A fiduciary responsible for plan investments has an obligation to manage the overall investment-management process through both selection and monitoring of plan investments. This includes:

- Diversifying portfolio assets according to participants' and beneficiaries' specific risk/return objectives
- Monitoring all money managers' and service providers' activities
- Controlling and accounting for all investment expenses
- Avoiding conflicts of interest and prohibited transactions
- Using prudent experts to make investment decisions

In what is known as the "Prudent Man Rule," ERISA states that the fiduciary is required to act "with 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."

In addition, ERISA provides that the fiduciary should diversify the investment alternatives to minimize the risk of large losses unless it is clearly not prudent to do so.

If the plan permits participant direction of investments, offering too many alternatives may create confusion and challenges from a communication and education standpoint. A fiduciary must remember that it is important for participants to understand their alternatives and are capable of making informed investment decisions.

The monitoring process includes not only quantitative considerations but qualitative analysis as well. There are several criteria that fiduciaries generally consider when evaluating plan investments:

- Changes in performance, including risk-adjusted performance
- Changes in the fund's investment style
- Fees: the expense ratio relative to the investment's benchmark and other costs
- Changes in personnel: portfolio manager tenure and turnover

A fiduciary's responsibility to manage the investment process is reinforced by various fiduciary statutes and case law dealing with breaches of fiduciary conduct and can be classified into several general categories:

- Failing to follow a structured investment management process
- Failing to adhere to investment provisions in plan or trust documents
- Selecting inappropriate asset classes
- Failing to diversify the portfolio
- Failing to avoid prohibited transactions (e.g., self-dealing)—keep in mind a fiduciary cannot personally benefit from the plan

The statutes and case law can provide fiduciaries with needed guidance on how to fulfill their responsibilities.

About 404(c): Participant directed investments

Under section 404 of ERISA, the plan sponsor for any type of retirement plan must discharge his or her duties solely in the interest of plan participants and beneficiaries. The plan sponsor must also diversify the plan's investments to minimize the risk of large losses unless such diversification is not prudent.

More specifically, section 404(c) refers to fiduciary responsibilities in the event that plan participants control assets in their accounts.

Plan sponsors may limit their fiduciary liability from investment losses if they give plan participants the opportunity to:

- Choose from at least three investment alternatives, each with different risk and return characteristics. Combined, these choices must allow the participant to minimize risk.
- Transfer assets at least quarterly. Further, the plan must let participants change to and from the least volatile investment category as frequently as it permits changes for the most volatile category.
- Make informed investment decisions based on the information about the plan and available investment alternatives furnished to them.
- Change salary deferral percentages at least quarterly.

The regulations do not require the plan sponsor to give investment advice to participants, but the sponsor should make sufficient information available so participants can make informed investment decisions.

Sponsors must still:

- Prudently select investment alternatives available to plan participants.
- Monitor the selected investments' performance.

This summary discussion of the 404(c) regulations does not include complete details. Fiduciaries should contact their tax or legal advisors for specifics as they relate to their specific plans or companies.

Breach of fiduciary responsibility

The following are some examples of fiduciary breaches:

- Failure to protect plan participants and beneficiaries
- Imprudent investment decisions have been made on the fund's or beneficiaries' behalf
- Fiduciary responsibilities have not been delegated appropriately to another qualified individual
- The plan is not operating according to the terms written in the plan document, and deposits are not made timely according to regulation

Depending on the breach incurred, a fiduciary can be held personally liable. Therefore, when acting in a fiduciary capacity, it is important to seek legal counsel to fully understand the responsibilities and potential liabilities of your fiduciary capacity. A fiduciary may purchase additional insurance with his or her own funds to help cover any liabilities resulting from a fiduciary breach.

Frequently asked questions

A fiduciary acts in the interest of a retirement plan's participants and beneficiaries. These questions and answers will help clarify key aspects of a fiduciary's role.

As a fiduciary, if I allow participant-directed accounts, does this eliminate my fiduciary responsibilities?

An employer who sponsors a qualified plan will always have fiduciary responsibilities. However, section 404(c) states that if a participant exercises control over assets in his or her account, a participant is not considered a fiduciary by reason of that control, and no other fiduciary can be held responsible for losses resulting from that control.

Can Wells Fargo Advisors be a fiduciary for my plan?

Under certain circumstances and using firm approved products, Wells Fargo Advisors may serve as an investment fiduciary.

What is a corporate trustee, and when should I consider one?

A corporate trustee is a financial institution that performs the duties and fulfills the responsibilities described in the plan document and trust agreement. Through its banking and trust affiliates, Wells Fargo Advisors offers different levels of corporate trust services, including:

- **Discretionary trustee.** Intended for organizations that want a trust services provider to take on fiduciary responsibility for selecting and monitoring plan investments.
- **Managing agent.** Targeted to those organizations that have either an individual as trustee or a board of trustees but still want the benefit of professional investment management.
- **Nondiscretionary trustee.** Designed for organizations that make their own investment decisions yet want a corporate trustee to administer their accounts (often referred to as a “directed trustee”).
- **Custodian.** Intended for those organizations that have either an individual as trustee or a board of trustees, are self-trustees of plans, or prefer to have multiple investment managers or a professional handle the assets.

When is the plan sponsor required to deposit employee deferrals and employer contributions into the plan?

The general rule states that employee contributions must be deposited on the earliest date of which the contributions can reasonably be segregated from the employer’s general assets but, in no event later than the 15th business day after the end of the month in which it would have otherwise been payable to the participants. For plans with fewer than 100 participants, the DOL provides a safe harbor if the deposit meets the general rule when contributions are deposited into the plan no later than the seventh business day following the day in which it would have been otherwise payable to the participant. The IRS and DOL closely review when the plan’s sponsor deposited the employee-deferral contribution. If either believe you could have deposited the contribution earlier, you may be in breach of your fiduciary duty. You have until the due date of taxes, including extensions, to make most company contributions.

Whom can I contact if I have questions concerning my plan?

You can contact your Financial Advisor from Wells Fargo Advisors or your tax or legal advisor. Wells Fargo Advisors has retirement plan staff that can answer many of your questions; however, some questions may have to be directed to the plan administrator. If you have exhausted all resources and still are not satisfied, you should contact the DOL in your area.

What common violations does the DOL find in its investigations?

- Improper valuation of plan assets in defined contribution plans, including real estate and employer stock
- Use of plan assets to benefit certain related parties-in-interest, including the plan administrator, plan sponsor, and people related to these individuals
- Failure to have established procedures for the selection of service providers
- Failure to transmit employee contributions in a timely manner
- Failure to make required employer contributions to pension plans
- Failure to administer the plan’s provisions as specified in the plan document (e.g., improper eligibility/enrollment procedures, vesting errors, unauthorized plan distributions (and to provide various required notices to participants))

The IRS offers several correction programs depending on the violations involved. Which program applies to your situation depends on the nature of the violation. Talk with your tax advisor or contact your local IRS office for details.

Can the plan sponsor invest the plan’s assets in employer stock and/or real property?

Yes. You can invest in either one; however, there are special considerations to keep in mind. Be mindful that including non-publicly traded securities in a retirement plan trigger complex and possibly expensive valuation issues for your plan. In addition, for a plan with fewer than 100 participants and more than 5% of its assets in nonqualified investments, you generally need to have an annual plan audit, which adds to the annual plan expense. You should consult an ERISA attorney before including such securities in your retirement plan.

How we can help

We offer many services to assist fiduciaries. Through our Financial Advisors, we can provide assistance with one or more of the following services:

- A sample investment policy statement, which establishes a process for setting goals and making investment decisions
- Asset allocation strategies
- Investment manager search and review
- Plan services and cost analysis
- Custody services*
- Trustee services*
- Full range of retirement-plan services

You can count on us

Wells Fargo Advisors offers a range of plans and can help you match the right plan with your needs and objectives.



**Trust services available through banking and trust affiliates in addition to non-affiliated companies of Wells Fargo Advisors. Wells Fargo Advisors and its affiliates do not provide legal or tax advice.*

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