

# ERISA CONTROVERSY REPORT

## Message From The Firm

*In this month's ERISA Controversy Report, two of our three articles don't actually relate to litigation or disputes—not directly anyway. Instead, they deal with issues that, if not properly addressed in advance, could lead to liability for benefit plan fiduciaries. Fred Reish's article discusses a proposed revision to the Department of Labor regulation regarding fiduciary status arising out of investment advice. In a nutshell, if the Department's proposal is finalized, persons in the chain of distribution for investment products will be more likely to be considered fiduciaries—and to have all of the potential liability that comes with fiduciary status.*

*My article regarding ERISA's bonding requirement scratches the surface of who may be required to be bonded under ERISA and the equally important but little understood question, "who is responsible for securing the bond?" You might be surprised at the answers.*

*Finally, my article describing a recent case we handled shows that in litigation involving employee benefit plans and employee benefit plan service providers, it is important to choose an attorney that not only knows employee benefit plans, but knows litigation as well.*

*As always, we hope you find our newsletter useful and look forward to your questions and comments.*

*Joe Faucher  
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## ERISA Fidelity Bonds—Who Needs Them, and Who is Responsible for Securing Them?



*By Joe Faucher (JoeFaucher@Reish.com)*

The Employee Retirement Income Security Act ("ERISA") requires that every fiduciary of, and every person who handles funds or other property of, an employee benefit plan, be bonded. This seems like a simple enough proposition. And yet, although the statute imposing the bond requirement has been in place for many years and the Department of Labor has issued guidance to clarify the requirement, we continue to field questions regarding its scope and meaning. When is a person considered to be "handling funds or other property" of a plan, and therefore required to be bonded? Who is responsible for obtaining the bond? What acts is the bond required to cover?

A thorough discussion of all of these questions is beyond the scope of this newsletter. However, it's difficult to overstate the importance of the bonding requirement, so this is as good a place as any to begin to address the subject.

### Who Must be Bonded?

As mentioned above, the statute requires every fiduciary and every person who handles funds or other property to be bonded. (Exceptions include banks, insurance companies and broker dealers.) This triggers two questions—who is a

"fiduciary," and what does it mean to be "handling" funds of a plan? The first question—who is a fiduciary—is not as easy to answer as it might first appear. Some persons are fiduciaries by virtue of their relationship to a plan. For example, a plan trustee is always a fiduciary. Other persons, however, become fiduciaries not because of any title they hold but as a result of the functions they perform. Generally speaking, persons who have discretionary authority or discretionary responsibility in the administration of a plan, or exercise discretionary authority or discretionary control over the management of the plan (or any authority or control, discretionary or not, over the plan assets) are plan fiduciaries, as are persons who provide investment advice to a plan.

The second question—who is "handling plan assets"—is also not susceptible to an easy answer. The DOL recently stated that if a person's duties and functions involve receipt, safekeeping and disbursement of plan funds, access to plan funds, or the ability to make decisions that might cause a loss to the plan due to fraud or dishonesty, the person should be considered to be handling plan funds, and therefore subject to the bonding requirement.

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## Fiduciary Status for Referrals



By Fred Reish ([FredReish@Reish.com](mailto:FredReish@Reish.com))

The DOL has proposed a new regulation to re-define fiduciary investment advice. The proposal broadly expands the activities that result in fiduciary status by virtue of giving advice. In addition, it formalizes a long-standing DOL position that the referral of an investment manager can result in fiduciary status for the adviser making the referral. As a result, if a solicitor's fee or finder's fee is paid to the adviser who makes the referral, that payment can be a prohibited transaction.

Before delving further into the proposal, let me describe the statute—so that you have a context for the discussion.

ERISA section 3(21)(A) is the provision that defines fiduciary status. There are three categories of ERISA fiduciaries. The first and third definitions deal with the management and administration of a plan and its assets. It is only the second definition—the so-called “investment advice” provision—that can cause a person to become a fiduciary by virtue of giving advice. Stated slightly differently, under the first and third definitions, a person will need either discretionary control or actual control in order to be a fiduciary. However, under the second definition, recommendations can result in fiduciary status. But that begs the question . . . recommendations about what? Conversationally, people have described the section as applying to advice about buying, selling, or holding investments. However, the DOL has historically had a broader definition. For example, the DOL considers the definition to include advice about the advisability of investing in securities and other property, including recommendations of investment managers. There is DOL guidance on that subject as early as 1984.

However, that position is not well known and, as a result, it is fairly common for advisers to refer investment managers to plan fiduciaries and participants, but not to consider themselves fiduciaries. By specifically including the referral of investment managers in its proposed regulation, the DOL has, at least from its perspective, taken steps to remedy the situation.

However, a reading of the proposed regulation would not necessarily lead to that conclusion. The proposal provides that a person can be a fiduciary if he “provides advice or makes recommendations as to the management of securities or other property.”

However, the preamble to the proposed regulation is clear. It says: “This would include, for instance, advice and recommendations . . . as to the selection of persons to manage plan investments.”

But it takes more than a referral to result in fiduciary status. The proposed test for fiduciary status has two prongs. The referral of an investment manager would satisfy the first prong. However, one of four conditions in the second prong must also be satisfied. The condition that is most likely to be applied—and undoubtedly to be argued about—is the requirement that the advice be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary. While it may be possible to refer an investment manager to a plan in a way that is not “individualized,” it will probably be difficult to show that the adviser did not consider the needs of the plan. That would be the case if, for example, the adviser gathered information about the plan or the participants.

This may be viewed as only a proposal. However, it is a long-standing DOL

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### ERISA Fidelity Bonds *continued from page 1*

#### Who is Responsible for Making Sure That All Persons Required to be Bonded Are Bonded?

ERISA §412—the statute that imposes the bonding requirement—states that it is unlawful for any “plan official” to permit any other plan official to receive, handle, disburse or otherwise exercise custody or control over plan funds or other property without first being properly bonded. In other words, persons who are required to be bonded are obligated to ensure that every other person that is required to be bonded is actually covered by a bond. For example, if a plan service provider is handling plan funds, the plan's trustee is obligated to make sure that the service provider is bonded. But the rule also works in reverse. That is, it is unlawful for a service provider to permit the trustee to perform the functions of trustee without being covered by a bond.

As a practical matter, the persons who are responsible for administering the plan—such as the plan committee, plan administrator and trustees—should identify all of the persons who may be “handling plan assets” within the meaning of the applicable regulations and should take steps to make sure they are covered by the terms of a bond.

#### If I Have Obtained a Bond, Does It Automatically Cover Everyone It Needs to Cover?

Maybe, maybe not. Different bond forms have different provisions, and the law does not require every bond form to cover every person that ERISA requires to be bonded. Plan fiduciaries should take the time to review their bond forms, ask questions about who is covered by the form and secure additional bonding (or require their service providers to secure an appropriate bond) if the bond in place covers fewer than all of the persons that are required to be bonded. ❖

## Efficient Resolutions of TPA Litigation



By Joe Faucher ([JoeFaucher@Reish.com](mailto:JoeFaucher@Reish.com))

Over the years we have represented numerous third party administrators (“TPAs”) in litigation matters. Because the process of administering employee benefit plans involves applying numerous technical complex laws and regulations, it is no surprise that litigation against TPAs can arise out of any number of actual or perceived errors in plan administration. One of the challenges in defending TPAs is that the claims often come down to a battle of expert witnesses. An expert witness on behalf of the plaintiff typically claims that the TPA somehow failed to properly perform the services for which it was hired, resulting in some damage to the plan or the plan sponsor, while an expert witness for the TPA argues that the TPA did everything within the standard of care, and/or that there was no damage as a result of the TPA’s conduct.

From the TPA’s standpoint, there are at least two problems associated with engaging in the “war of the experts.” The first is that litigation that turns on opinions by competing experts is not likely subject to early resolution. The second problem—which flows from the first—is that by the time the litigation advances to the stage where the experts are fully prepared to present their opinions, the cost of the litigation may approach or even exceed the amount of the plaintiff’s claimed damages.

Consequently, attorneys for TPAs need to be on the lookout for ways to resolve cases that do not depend upon waging the war of the experts. One recent case we handled provides a good example. In this case, our client purchased the assets of a third party administration firm. Well in advance of the purchase,

the “seller” provided services for a client with a defined benefit pension plan. The relationship between the seller and its client broke down. Sometime later, the client sued the original TPA firm (the “seller”), several individuals who had been employed by the seller and our client, claiming that several errors had occurred in connection with the termination of the defined benefit plan, which caused the plan sponsor to have to pay significant additional amounts that it claimed could have been avoided. Our client, however, never provided any services for this client. However, the seller had gone out of business and been dissolved before the lawsuit was filed.

Before we became involved in the case, our client had been paying the costs associated not only with its own defense, but of the defense of one of the selling firm’s employees. When we took over our client’s representation from another firm, we did so only on behalf of the buyer firm and not the prior company’s employee. We reviewed the situation and determined that the claims against our client were shaky at best because they depended on notions of “successor liability.” We focused our efforts immediately on this issue. When we brought the issue to the attention of the plaintiff’s attorney, we persuaded him how difficult it would be to obtain a judgment against our client, even if our client’s predecessor might have been liable for his client’s claims. We ultimately settled the matter for a fraction of what it would have cost to litigate the case through trial—with its attendant “war of the experts.”

Successful litigation of technical employee benefit plan issues requires not only a solid grasp of how employee benefit plans work, but an equally strong understanding of how the

litigation process works. Many attorneys understand litigation. In those cases where our clients also need an attorney who understands how employee benefit plans work, we are there to help. ❖

### Most Influential People in Defined Contribution

Fred Reish, founder and shareholder in the firm, was named as one of the 10 most influential persons in the 401(k) industry by a survey conducted by The 401kWire. He was the only practicing attorney listed in the top 10.

Fred has been included in the top 10 in every year of the survey—which allows participants in the retirement plan industry to register their views through a voting process.

We believe that the recognition is based on the quality, depth and breadth of our ERISA legal practice, as well as Fred’s activities as a writer, speaker and commentator on developments and trends in the retirement industry...and particularly for 401(k) plans.

To view the complete list, please click on the following link: <http://tinyurl.com/401kwire>

### Fiduciary Status

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position. As a result, advisers and providers who work with investment managers should review their practices to ensure that they engage in a prudent process to select investment managers (and, possibly, to monitor them). In addition, broker-dealers, RIAs, providers and others who refer investment managers should ensure that they are not engaging in prohibited transactions because of, *e.g.*, the receipt of solicitor’s fees.

Finally, as a risk management suggestion, advisers should review their insurance coverage to make sure that they are covered for fiduciary claims of this type. ❖

## Around the Firm

**Speeches:** On December 8th, **Heather Bader-Abrigo** and **Summer Conley** conducted a webcast on “Healthcare Reform for Employers” to R&R’s clients and advisors. On January 13th, **Bruce Ashton** presented a workshop on “Fiduciary Fallout: Educating Clients on Fiduciary Duties and Protecting Yourself” at the Los Angeles Benefits Conference, held in Los Angeles, on January 12th to the 14th. At the Las Vegas ASPPA 401(k) Summit, held on March 6th to the 18th, **Fred Reish** will present workshops on “Fiduciary Fallout: Educating Clients on Fiduciary Duties and Protecting Yourself” and “Fee Disclosure Regulation Under 408(b)(2) Resuscitation Complete.” He will also moderate a peer-to-peer networking session on “Medium Plan-Size Market.”

**Quotes:** In the Year In Review 2010 issues of the *Plan Sponsor* magazine, **Fred** was interviewed for the article “In the Footsteps of a Fiduciary.” He was also quoted in the article “Excessive Forces,” published in the December 2010 issue.

**Articles:** In the Fall 2010 issue of *WP&BC*, **Steve Wilkes** wrote an article on “Your Retirement Plan Services Agreements: Every Word counts!” In the January Issue of the *Plan Sponsor* magazine, **Fred** wrote a column entitled “Class—ifying Mutual Funds: The Duty to Understand Mutual Fund Costs.”

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