

# soundwaves

NAVIGATING THE FUTURE  
Information and Risk Management Ideas for Not-for-Profit Organizations

## Managing Pension Funds

### *Understanding Your Fiduciary Role Is Key to Mitigating Risk*

Once upon a time people worked for one company their entire careers and enjoyed a full benefits package, a guaranteed pension, and the knowledge that Social Security would supplement their income in the future. In those days of yore, no one worried about retirement. After all, they knew they had a stable source of income in their golden years.

Those days are largely history. Today, people change jobs as often as they change cars, politicians are debating whether Social Security is in jeopardy, and generous employer benefits are rare. Nowadays, many Americans have awakened to the reality that the only money they're certain to have in retirement is the funds they can save today. All of which makes pensions, and the way they are managed by employers, vitally important. Mess with the company pension fund, and you're likely to be sued faster than you can sort out the paperwork.

Fortunately, there are rules to guide employers in managing pension funds. And these rules apply equally to for-profit and non-profit organizations. The Employee Retirement Income Security Act (ERISA) sets out the basic rules for determining

- Who is a fiduciary,
- The responsibilities of a fiduciary, and
- Fiduciary liability.

"Under ERISA, a company can be a fiduciary," says Bruce Schwartz, a partner in the White Plains office of Jackson Lewis. "Of course, in practical terms, one or more individuals have to operate the plan for your organization."

To guide fiduciaries, ERISA sets out three key requirements. The first, the exclusive purpose rule, states that the fiduciary must operate a plan for the exclusive purpose of providing benefits and defraying the reasonable expenses of administering the plan. The second, the prudent person rule, states that the fiduciary has to act with the "care, skill, prudence, and diligence under the

circumstances that a prudent man would use in their conduct." The third, a diversification rule, states that the fund has to diversify the investments in the plan to minimize the risk of large losses.

"The key," says Schwartz, "is to make sure that the person appointed fiduciary is willing to do the job and understands his or her obligations."

Fiduciaries are responsible for plan administration and investment decisions. They are not, however, responsible for plan design. This means that decisions about how plans are set up, or decisions to amend or terminate a plan, fall outside the fiduciary's area of responsibility.

The responsibilities of a fiduciary include

- Day-to-day fund administration,
- Making sure that needed disclosures are made,
- Reviewing investments, and
- Talking to an expert on a periodic basis to make sure the investments are sound.

"In addition to talking informally to an expert at least on a quarterly basis, the fiduciary should probably hold an annual meeting with that person to review your investments and look at how they are doing in relationship to other investments," advises Bruce Schwartz. "And ask questions such as: Have the mutual fund managers changed? Is the fund still investing in the same type of investments as originally described? For example, if the fund says it invests in overseas capital growth, is it still doing that? How do the fund's fees compare to those of other funds?"

In other words, while retirement fund fiduciaries aren't expected to be financial wizards, they are expected to consult with people who have investment expertise. "ERISA does not require that you be right," says Schwartz. "What it does require is that a fiduciary does his or her homework."

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### Inoculating Against Lawsuits

There's probably little that engages most people's attention more than the ups and downs of their financial investments, whether it's a teenager dabbling in penny stocks or a financier juggling multimillion-dollar accounts. When the market soars, we envision a future of wealth and luxury; but when the market tanks, we're often casting around for someone to blame.

"When fiduciary liability claims occur," says Rachel Freedman, director of employment claims, CNA, "they can be pretty severe."

There are two different insurance vehicles that govern aspects of an organization's retirement fund: fiduciary liability coverage and employee benefit liability coverage. Put both policies in place in your organization and you're generally protected against breach of fiduciary claims as well as problems stemming from poor plan administration.

"You need a fiduciary liability policy to cover claims of breach of fiduciary duty," explains Freedman, who advises organizations to purchase these plans to cover anyone who serves as an administrator or trustee of a pension plan. "You should also have employee benefit liability coverage to protect your organization against claims of improper plan administration." The latter insurance covers alleged negligent handling of records, inadequate financial counseling of employees, and related activities.

A third type of insurance policy, the ERISA bond, covers plan assets. If someone embezzles plan funds, the ERISA bond will cover that money-but not the fiduciary's perceived responsibility for safeguarding the funds. Under ERISA, "the individual trustees or plan administrators can be sued for various types of liability," says Freedman, "including a charge of negligence for allowing a theft to happen in the first place." ♦

## (Managing Pension Funds continued)

Rachel Freedman, director of employment claims, CNA, reiterates the need for fiduciaries to do their homework. "One of the big things that we see claims arising out of, especially on the non-profit side, is people without investment expertise who volunteer to be plan administrators or plan trustees," says Freedman. "They hire outside advisors and then rely exclusively on other people's advice. Then the plan goes belly up, and they are held liable as a fiduciary. And a defense of 'I didn't know what was going on' doesn't hold a lot of water."

### Avoiding Liability

The key to avoiding fiduciary liability lies in making prudent decisions and consulting periodically with financial experts. Where companies and non-profits sometimes get into trouble, however, is if they make a truly terrible investment decision or select a fund that has unusually high internal fees.

Many funds offer the equivalent of one-stop shopping, in which the cost includes both fund fees and record-keeping and other administrative service charges. Unbundling the various services generally costs more

than selecting a package arrangement. As a result, these one-stop deals are attractive to many organizations.

"Under ERISA, plans are allowed to pass along to participants all the internal plan expenses," says Bruce Schwartz. "What makes it difficult for smaller organizations is that they generally don't have the time and wherewithal to figure out which is the best deal among the welter of different fee arrangements."

In the case of participant-directed accounts, ERISA also allows companies and non-profits to pass through to participants the responsibility for selecting among available funds, as well as the responsibility for deciding how much money to put into each fund. A participant is on his own if he makes a bad investment. "If an employee puts all his money into risky high-tech stocks that go belly up, the company doesn't bear any fiduciary responsibility for his losses," says Schwartz, "as long as the organization applies the rules correctly." It is important, however, to remember that the fiduciary remains liable for determining which funds are offered to participants.

Fiduciaries also have a duty to make sure the outside company they have hired to handle account management is doing so in a competent manner. "You should be checking on how your vendors are doing," advises Schwartz. "And keep in mind the prudent person rule. If there's nowhere else to go for these investment services, or no one else does it better, or your vendor is in the mainstream on fees, even though your vendor may not be great, you're not expected to create something that doesn't exist." Which means, if the perfect provider isn't out there, you're not required to invent it.

The bottom line for non-profits, says Schwartz, is that they have the same responsibilities as for-profit companies in running retirement plans. "You have to do your homework and not assume the plan will run itself," he says. "Although it doesn't entail a lot of work in most cases, you still have to pay attention to it."

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