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CHAPTER 1
FIDUCIARY RESPONSIBILITY

If you are the trustee of an employee benefit plan, a foundation, endowment or a common-law trust, you are probably a fiduciary, and as such have certain specific responsibilities, duties and liabilities. Generally we use ERISA as the prototype for fiduciary responsibility. However, it must be noted that ALL financial relationships in which someone else has a claim to the assets, like the beneficiaries of a trust are subject to fiduciary rules and requirements. We will examine the various regulatory requirements in the next chapter. Being a Trustee has fiduciary implications and should not be taken lightly.

Fiduciaries have to provide individualized investment advice given pursuant to a mutual understanding (read: contract) on a regular basis pertaining to valuation or recommendations as to investing for a fee. In the investment management consulting arena, this defines the money manager, and often the financial advisor, broker, or consultant. The duties of a fiduciary require unconflicted loyalty to the client first and the penalties for fiduciary breach are stiff, as discussed above. There are five general standards, which govern a fiduciaries conduct.

1.They must be solely in the interest of the participants and beneficiaries. Benefits must inure to the individual plan participants who have a right to monitor the activities of the fiduciary and the investments of the plan. But the trustees aren't listening.

2.They must be for the exclusive purpose of providing secure benefits to participants and their beneficiaries. But the trustees aren't listening.

3.They must be discharged in accordance with written instruments and documents which should include written investment objectives. Fiduciaries have the right to rely on professionals to assist them through this process. But the trustees aren't listening.

4.Investment duties must be discharged with the care, skill, prudence and diligence of an expert familiar with such matters. A fiduciary must consider all the facts and circumstances he <u>should know</u> are relevant to the plan's investment objectives. But the trustees aren't listening.

5.Investments must be diversified so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so. It is difficult to conceive of a situation where it would be clearly prudent not to minimize the risk of large losses. But the trustees aren't listening.

Any plan fiduciary who breaches fiduciary responsibility rules is personally liable for losses caused by the breach. This liability extends to the owner, corporate officer, director, trustee, administrator, investment manager, and service provider. Furthermore, if a fiduciary knows or should have known of a breach by another fiduciary, he may be personally liable. Finally, a non-fiduciary who participates in, conceals or knows of a b reach may be personally liable. Ignorance, lack of experience, failure to be informed or faulty communications will not be defenses. As a stark example, a trustee who is responsible for investing plan assets will have to pay out of his pocket losses to the plan as a result of imprudent investments. In a case of a failure to diversify, the fiduciary is personally liable for losses or missed opportunities resulting from the no-diversified excess. Losses may be determined by comparing the earnings from the improper investment with what would have been earned in other investments. The most profitable investment is taken as the standard. Courts will consider market advantages to holding the asset, conditions affecting price of the improper purchase and other plan assets as well as the beneficiaries' interests. Liability may include interest and attorneys' fees.

Courts use the comparative total return analysis to examine investment losses. The prudence of individual investment decisions is judged on the condition of the fund as a whole. The same factors that go into setting prudent investment objectives are those which are used to judge the actual asset investments. These include risk, return, liquidity, cash flow requirements, income, funding objectives and portfolio composition. The prudence of an investment is based on the time it is made, not on subsequent performance. This is why the initial selection of the investment is the most critical factor in the investment process.

Penalties may be imposed six years after the breach of duty or other fiduciary violation or three years after the party bringing suit had actual knowledge of the breach.

A willful violation will carry personal criminal penalties and up to a 20% fine and one year in prison for reporting or disclosure violations.

Civil actions can be brought by participants, beneficiaries, fiduciaries, and the various Regulators. Losses to the plan must be restored as well as profits made from the use of plan assets. Failure to disclose information to participants will incur a substantial penalty. Injunctions, removal from duties, and placement of control over assets may be taken by the Department of labor.

While a fiduciary can purchase fiduciary insurance, it is an extremely expensive proposition. Indemnification agreements can be made, errors and omissions coverage obtained, or liability coverage purchased. These will in no way relieve the fiduciary from liability. The only way to avoid the liability is by proving that the fiduciary acted with prudence at all times.

All plans and their advisors must have bonding on officials which at least provides protection to the plan for losses that might arise due to the dishonest activities of someone who exercises any control over plan assets.