Fiduciary Liability Loss Prevention

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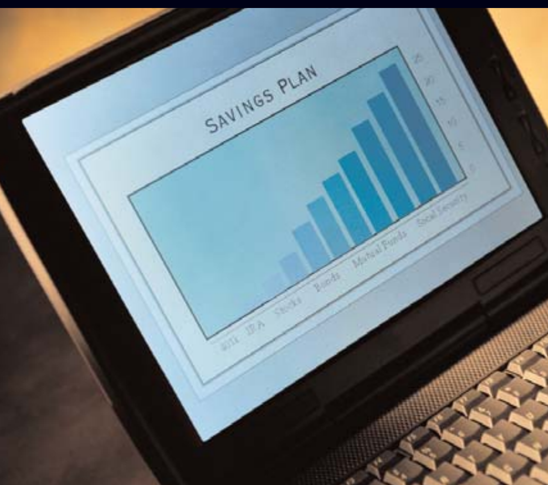

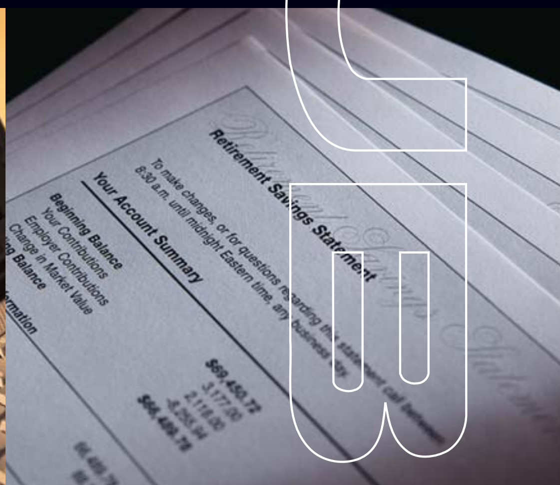

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FIDUCIARY LIABILITY LOSS PREVENTION

Prepared by

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For the Chubb Group of Insurance Companies

PREFACE

The Employee Retirement Income Security Act of 1974 (ERISA) ushered in a new world of liability for fiduciaries of employee benefit plans. Since then, numerous amendments to ERISA and other laws governing fiduciary conduct have continued to weave a complex and challenging environment in which to administer these plans. Lawsuits are increasingly brought against fiduciaries, subjecting them to personal liability as well as expensive, time-consuming legal proceedings. As a leading provider of fiduciary liability insurance, the Chubb Group of Insurance Companies believes that sound risk management practices can minimize exposure to litigation and enhance the performance and efficient administration of employee benefit programs.

Chubb commissioned Dan A. Bailey, a partner in the law firm of Bailey Cavalieri LLC, to prepare *Fiduciary Liability Loss Prevention* to help fiduciaries and their employers protect themselves from litigation arising from their professional duties. It discusses the general principles governing fiduciary liability, reviews many potential exposures, and suggests step-by-step loss prevention procedures. Although we believe this resource offers important guidance and can help fiduciaries of employee benefit plans and their companies develop effective loss prevention strategies, it is not a substitute for prudent legal advice. We encourage the reader to seek advice from competent counsel for any specific issues that arise when designing and implementing loss prevention procedures.

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INTRODUCTION

Prior to 1974, fiduciary loss prevention was relatively simple. Employee benefit plans typically contained an exculpatory provision that purported to relieve plan fiduciaries from liability for wrongful acts. The enactment of ERISA eliminated this absolute protection. Although fiduciaries, their advisors, and the courts have given great attention to the meaning and effect of ERISA, only limited attention has been given to effective fiduciary loss prevention.

An effective fiduciary loss prevention program may accomplish numerous objectives:

- Reduce the liability exposure of fiduciaries, as well as the sponsoring employer to the extent the employer may indemnify losses incurred by the fiduciaries.
- Enhance the performance and efficient administration of the plan.
- Avoid time-consuming, distracting, and potentially embarrassing claims and litigation.
- Enhance the defense of claims and reduce the potential recovery by a claimant.
- Improve the ability to obtain favorable fiduciary liability insurance coverage at reasonable cost.
- Improve employer-employee relations.

The following discussion identifies various areas in which fiduciary loss prevention opportunities exist and should be considered. Although some fiduciary loss prevention concepts may seem obvious, others may differ from historical practices. Fiduciaries may have difficulty objectively evaluating the necessity and appropriateness of some loss prevention concepts, particularly if they have not been the subject of a claim. Accordingly, outside consultants may be useful in evaluating, structuring, or implementing programs specifically tailored to a particular plan.

GENERAL PRINCIPLES GOVERNING FIDUCIARY LIABILITY

Basic Fiduciary Duties Under ERISA

ERISA regulates the conduct and duties of employee benefit plans, their fiduciaries, and other persons. The scope and effect of ERISA is not easily understood, and expert assistance is frequently required in interpreting and implementing ERISA provisions. What follows is a simplified overview of employee benefit plan fiduciary regulation by ERISA, subject to numerous qualifications and exceptions. In addition, various state statutes are preempted to the extent that they are inconsistent with ERISA.

What Is an Employee Benefit Plan?

ERISA broadly defines employee benefit plans that are subject to its regulation to include "any plan, fund, or program established or maintained for the purpose of providing to its participants or beneficiaries employee benefits." Included within this definition are employee pension plans and employee welfare plans.

Employee pension plans include pension, profit-sharing, and stock bonus plans that are qualified under the Internal Revenue Code of 1986, as well as certain nonqualified deferred compensation arrangements, such as "top hat" plans.

Employee welfare plans include plans, funds, and programs that provide medical, surgical, or hospital care; vision or dental benefits; benefits in the event of sickness, accident, disability, unemployment, or death; prepaid legal services; day-care centers; and educational assistance programs.

While most employee benefit plans are documented, ERISA does not require a plan, fund, or program to be in writing or otherwise documented. ERISA has been interpreted broadly by courts to include very informal employment practices. ERISA, however, does not apply to benefits that are paid from the general assets of the employer, such as sick pay, vacation pay, severance pay, and bonus programs. Careful structuring of certain employee benefit programs by knowledgeable ERISA experts can avoid inadvertent application of ERISA rules to programs and their administrators.

Who Is a Fiduciary?

ERISA takes a functional approach in defining who is a fiduciary. For ERISA purposes, a fiduciary is any person so named in the plan instrument or "any person who exercises any discretionary authority or control with respect to the management or administration of the plan or its assets." Fiduciaries are also individuals who render or have responsibility or authority to render investment advice for a fee or individuals who have discretionary authority or responsibility in the administration of a plan. Fiduciaries typically are plan sponsors, plan administrators, trustees, and investment managers, and they may also be other persons who have authority over any aspect of the plan or its assets. The definition of "fiduciary" is deliberately broad in order to hold accountable all those individuals who may be responsible for misuse of plan assets or loss to plan participants.

Particularly in the context of so-called stock-drop or tagalong class-action lawsuits (see discussion about these lawsuits on page 25), some courts are expanding the definition of "fiduciary" to also include the sponsor company's board of directors or its compensation committee if the directors either directly or as an agent of the sponsor company have the power to appoint fiduciaries of the plan. The courts reason that because of this power to appoint fiduciaries, the directors have an ongoing duty under ERISA to monitor the performance of the fiduciaries, thus making the directors fiduciaries themselves.

Fiduciary Standards

ERISA imposes upon fiduciaries four rules designed to protect the interests of plan participants and beneficiaries: (1) the exclusive purpose rule, (2) the prudence rule, (3) the diversification rule, and (4) the plan documents rule.

1. ***Exclusive purpose rule.*** All activities and transactions performed on behalf of the plan must be for the exclusive purpose of providing benefits to plan participants and defraying reasonable expenses of administering the plan. Courts have expanded this rule to hold liable fiduciaries who affirmatively, or by omission, misrepresent material facts about a benefit plan. The U.S. Supreme Court has found fiduciary liability in misstatements about future employer decisions, and several circuit courts have similarly held that an employer would violate its fiduciary duties by misrepresenting its future plans or intentions for the employee benefit plans it sponsors.

2. ***Prudence rule.*** Fiduciaries are required to exercise the same care, skill, prudence, and diligence that a prudent person familiar with such matters would exercise in managing similar affairs.

3. ***Diversification rule.*** Plan investments must be diversified in order to minimize the risk of large losses, unless diversification is clearly imprudent.

4. ***Plan documents rule.*** Fiduciaries must act in accordance with the plan document unless it is inconsistent with ERISA, in which case ERISA standards must be followed.

Prohibited Transactions

ERISA forbids fiduciaries from engaging in the following types of transactions:

1. ***Self-dealing transactions.*** A fiduciary may not use plan assets for personal gain, may not engage in transactions on behalf of parties whose interests are adverse to the plan, and may not realize personal gain in connection with any plan transaction (more about this under "Conflicts of Interest" on page 22).

2. ***Party-in-interest transactions.*** Otherwise legitimate transactions involving plan assets are prohibited if the transaction is with a "party-in-interest." A party-in-interest includes any fiduciary, counsel, or employee of the plan; anyone providing services to the plan; any employer or employee organization whose employees or members are covered by the plan; and any other person or entity that has a stated interest in or relationship with a party-in-interest. Prohibited transactions with a party-in-interest include the direct or indirect sale, loan, exchange, or transfer of any plan assets. Certain exemptions exist from these prohibitions, provided certain conditions are met (more about this under "Conflicts of Interest" on page 22).

Fiduciary Liability

Fiduciaries who are found to have breached any ERISA duty are personally liable for any plan losses resulting from the breach and for any profits that were attained through the misuse of plan assets. Fiduciaries may also be liable for statutorily imposed penalties and reasonable attorney fees and costs incurred by the plaintiff. This liability can arise with respect to errors or omissions both by the defendant fiduciary and by a co-fiduciary if the defendant fiduciary knowingly participates in or conceals, enables, or fails to remedy a known breach by the co-fiduciary. A lawsuit to establish the liability of a fiduciary may be brought by the Secretary of Labor, any plan participant or beneficiary, or by another plan fiduciary.

Most Common Types of Fiduciary Claims

The most frequently alleged claims against fiduciaries are:

- Denial or change of benefits.
- Administrative error.
- Incorrect benefit calculation.
- Improper advice or counsel.
- Misleading representation.
- Wrongful termination of plan.
- Civil rights denial or discrimination.
- Failure to adequately fund a benefit program.
- Conflict of interest.
- Imprudent investment.
- Cash balance plan conversions.
- Employer stock investments.

The large majority of fiduciary claims are brought by past or present employees or their families.

SELECTION OF FIDUCIARIES

Too frequently, fiduciaries are selected based upon corporate position, personal relationships, or other potentially irrelevant factors. The sponsoring employer is often designated as the plan administrator without identification of specific individuals to discharge its duties. However, where possible, individuals possessing the time, interest, and qualifications to adequately perform the duties of a fiduciary should be selected.

The designation of a fiduciary must take into consideration both the likely performance of a candidate and the demands of the position. Matters that should be considered with respect to the selection of fiduciaries include:

Eligibility requirements. ERISA prohibits certain persons from serving as fiduciaries or in certain other capacities. Generally, this prohibition applies to persons who have been convicted of various criminal offenses. A potential fiduciary should complete a questionnaire or otherwise verify in writing that he or she satisfies the ERISA eligibility requirements.

An additional eligibility requirement exists with respect to Taft-Hartley plans, which by law must have an equal number of management and employee-representative trustees.

Fiduciary attributes. To effectively represent the interests of plan participants, fiduciaries must be capable and willing to exercise independent judgment. If possible, persons who are independent from the plan sponsor should be selected. Mere figureheads or persons who are likely to simply "rubber stamp" the desires of the sponsoring organization should be avoided.

The qualities of an effective fiduciary include strength of character, an inquiring and independent mind, practical wisdom, and mature judgment. Other commitments of the candidate should be examined to assure that the person has adequate time and does not have a conflict in serving as a fiduciary for the plan. Because many fiduciary responsibilities are discharged through support staff, the resources and back-up capabilities of the fiduciary should also be examined, including the size and experience of staff likely to be involved with the plan, data processing experience and capabilities, and expertise of legal, accounting, and other professional advisors.

Evaluation of fiduciaries. Most fiduciaries are appointed for an indefinite term and serve until they resign or are discharged. It is therefore critical that their performance be periodically reviewed and evaluated by the sponsoring organization, by co-fiduciaries, and by outside consultants if possible. Evaluations should seek to identify, to the extent applicable to each fiduciary, complaints or criticisms by plan participants, beneficiaries, or regulators; administrative time and cost efficiencies; investment performance; and fiduciary effectiveness.

Fiduciaries should be viewed as having a long-term relationship with the plan in order to provide desirable continuity and to avoid the expensive and time-consuming process of changing fiduciaries. However, a sponsoring corporation should not avoid changing fiduciaries at the cost of jeopardizing proper administration of the plan. When performance concerns are identified, corrective action should be taken promptly. Failure to address a problem will likely magnify the problem and require more severe corrective action at a later date.

ACTIONS BY FIDUCIARIES

Education

To fulfill their legal responsibilities, fiduciaries must have an intimate familiarity with the plan documents and the duties and responsibilities of the plan and the fiduciaries. Because the legal environment in which the plan operates and in which fiduciaries serve is constantly changing, the need for education is continual.

Every newly selected fiduciary should review all applicable plan and trust documents. An orientation program should also be provided to familiarize the new fiduciary with the relevant procedures, personnel, and other background information relating to the sponsoring organization and the plan. It is advisable for new fiduciaries to meet privately with other fiduciaries and outside advisors (including legal counsel, independent auditors, and investment managers) to get their impressions of the plan's legal and financial situations and programs.

A legal orientation or an ongoing education program should also be provided to fiduciaries. The fundamental duties of fiduciaries should be reviewed and understood. Legal guidelines should be presented, ranging from basic operational procedures (such as always indicating on an executed document the capacity in which the fiduciary executes the document) to a more in-depth review of the important statutes, rules, and regulations restricting or regulating the conduct and operations of the plan and its fiduciaries.

Thoughtful, Informed Decision Making

If the sponsoring organization is designated the plan administrator, specific persons within that organization should be formally identified as discharging the responsibilities of the plan administrator. Those individuals should attend regularly scheduled meetings that are of sufficient length to adequately and completely analyze the matters under consideration. Adequate information concerning all important matters requiring attention, together with a detailed agenda and copies of minutes of the previous meeting and of any committee or co-fiduciary meetings, should be distributed approximately one to two weeks in advance of meetings. Less time, however, may be sufficient in emergencies. If information cannot be disseminated in advance, adequate time should be set aside at the meeting to review and understand the information presented. If for any reason a fiduciary does not receive sufficient information or have time to evaluate the information, action should be delayed until sufficient time and information can be made available and the fiduciary has had adequate time to thoughtfully evaluate the information. The information distributed in advance should include, where available, written reports or memoranda from advisors or other persons describing the issue and setting forth recommendations and the reasons for those recommendations; copies of any operative documents; an executive summary of documents that are particularly long, complex, or technical; and proposed resolutions relating to the issue. Fiduciaries should carefully and critically analyze these materials prior to the meeting.

The meeting should be conducted in an unbiased manner and in an atmosphere that encourages open discussion. Fiduciaries should be provided ample opportunity to actively question and challenge advisors and one another. The purpose of the meeting is not so much for fiduciaries to act as a single unit but to let them exercise a healthy skepticism toward proposals and to hear different viewpoints and ideas. Unchallenged reliance upon recommendations subjects fiduciaries to potential liability.

Inevitably, not all fiduciaries will agree with the decision of the majority. A dissenter should affirmatively vote against a proposal because mere abstention from voting may be deemed by the courts to be tantamount to approval.

Oversight Responsibilities

Typically, many plan functions are performed by support personnel. Fiduciaries are required to monitor that performance and may not abdicate their responsibilities through use of support staff.

Well-defined and understandable procedures should be implemented and enforced with respect to routine operational matters, such as the determination of employee eligibility, participation, hours and years of credited service, contribution allocation, breaks in service, and compliance with any statutory limitations on contributions and benefits.

In addition, procedures should be implemented for determining the accuracy of official reports, employee compensation as a basis for computing plan benefits, Social Security benefit offsets, participant entry and termination, and beneficiary death records. These procedures should also include protective devices against loss or error in plan data transmission and protective security for plan records, computer systems, and other valuable information.

Timely, accurate, and understandable communications to participants and beneficiaries concerning eligibility for and the amount of benefits will reduce the number of fiduciary claims, many of which result from a lack of effective communication.

Documentation and Observance of Formalities

Maintenance of accurate and complete minutes of all deliberations and other documents relating to the conduct of fiduciaries is one of the most important and most frequently neglected areas of loss prevention. At a minimum, minutes of meetings should document the matters discussed, record any recommendations given by advisors, and set forth resolutions approved, actions taken, and decisions made. Following are some fundamental principles that should be considered when preparing minutes:

- Minutes should clearly and concisely set forth exactly what occurred at the meeting, including any limitations placed on the action taken or authority granted and any conscious decision not to act.

- Minutes should describe what matters were considered and discussed and which authorities were relied upon in reaching the decision.

- If documents are incorporated by reference or attached to the minutes, they should be clearly identified in the minutes themselves.

- Minutes should be reviewed prior to finalization, not only by the fiduciaries but also by legal counsel.

- Minutes should reflect the results of any vote taken and identify by name all fiduciaries who voted against an approved transaction.

Fiduciaries should carefully review not only minutes of meetings they attend, assuring themselves that the minutes accurately reflect what transpired and their participation at the meeting, but also the minutes of any meetings they did not attend. If an absent fiduciary dissents or disagrees with actions taken at a meeting, the objections should be put in writing and submitted to the other fiduciaries for their information and for filing in the official minute book.

All documents relating to fiduciaries should be prepared with the expectation that they will be closely scrutinized in the future for evidence of wrongdoing. Imprecise wording, inflammatory or vulgar phrases, and ambiguous language should be avoided. The context of a document that appears innocent when prepared may appear quite different when read at a later date.

Documentation relating to investment decisions is particularly important. Documents should exist that evidence not only the reasons for making purchase and sale decisions on behalf of the plan but also a periodic analysis of the investment and its continued suitability for the plan, particularly in light of changing market conditions. Every investment should be continually evaluated in terms of the funding policy and objectives of the plan, and that evaluation should be reflected in the minutes. If the plan enters into real estate loan transactions, fiduciaries should maintain records comparable to those of a commercial financial institution, including appropriate appraisals, rent rolls, title information, credit reports, and other documents evidencing the prudence and security of the loan. For self-directed accounts, the fiduciaries should periodically review and document the usage by participants and the effectiveness of investment services and participant education programs, as well as the degree of diversification by the participants and other investment patterns.

In essence, fiduciaries not only need to act reasonably but also need to be able to prove they acted reasonably through well-drafted and comprehensive documentation.

DELEGATION OF RESPONSIBILITY

Ironically, while the law requires increasing levels of expertise and diligence by fiduciaries, rules restricting the compensation of fiduciaries who are full-time officers or employees of the sponsoring organization have been strictly construed. The effect is that most named fiduciaries are discouraged from spending extensive time on plan-related matters. Consequently, proper operation of the plan and protection of the participants requires delegation of responsibility by the fiduciaries and reliance on competent support services and professionals.

Fiduciary Delegation

Fiduciaries are generally not liable for a breach of duty if that duty has been specifically delegated to another fiduciary. This defense applies only if the plan document specifically authorizes the delegation. The plan authorization should be as explicit and detailed as possible.

Fiduciaries must exercise reasonable prudence in delegating responsibilities. The persons selected must satisfy ERISA qualifications and be capable of adequately discharging the responsibilities delegated. Before the selection, fiduciaries should investigate and document the qualifications and backgrounds of candidates.

Examples of delegation that could be authorized and implemented include:

- The responsibility for establishing or overseeing the diversification and prudence of investments could be allocated to an asset manager.
- The responsibility for monitoring changes in reporting and disclosure obligations and ensuring compliance could be delegated to a designated individual.
- The responsibility for developing and implementing procedures with respect to high-risk areas—such as investments in the employer's

securities, tender offers, leveraged employee stock ownership plans (ESOPs), and prohibited transactions—could be delegated to a designated individual or committee.

Fiduciaries may delegate responsibility for the management or control of plan assets only to an investment manager who is a registered investment advisor, a bank, or a qualified insurance company and only if the investment manager acknowledges in writing its fiduciary status with respect to the plan. Because the plan trustee and named fiduciary avoid liability for the acts or omissions of the investment manager only if those two conditions are satisfied, it is essential that the qualification status and written acknowledgment of the investment manager be well documented in the official records of the plan.

Fiduciaries must act prudently, not only in originally delegating responsibility but also in continuing the delegation. An active and comprehensive monitoring program should be implemented to evaluate the performance of the appointee and the appropriateness of continuing the delegation. Depending upon the circumstances, this evaluation can occur through formal periodic reviews, day-to-day contact, or other appropriate ways. The monitoring process should critically scrutinize the relevant issues and should not become a mere formality. In many areas of fiduciary delegation, auditors who specialize in performing this monitoring function on behalf of the fiduciary are available to assist the fiduciary in structuring and implementing an appropriate oversight program.

An effective review process must include the willingness and ability to discharge an appointee if circumstances require it. Arrangements with the appointee should contemplate and permit prompt termination within reasonable limits.

Support Services

Many administrative functions are performed for fiduciaries by service providers whose level of responsibility and authority do not make them fiduciaries. Selection of support personnel should be carefully considered. A well-coordinated team of professional, conscientious persons should be assembled. All service providers should have clearly defined responsibilities and written contracts documenting those responsibilities.

When selecting support personnel, fiduciaries should avoid unnecessary or frequent turnover. There is typically an extended learning curve for these personnel that creates the potential for inefficiency and inaccuracies by newer personnel. The likelihood of errors or omissions is greatest during a period of personnel transition, so transitions should be minimized when possible. If unavoidable, special attention should be given by the fiduciaries to assure that all necessary functions are properly performed.

Use of Legal Counsel

From a loss prevention standpoint, perhaps the most important advice to fiduciaries is rendered by qualified legal counsel who should be consulted frequently. Experienced counsel can help make decisions and other conduct by fiduciaries as impregnable as possible. Legal advice not only helps guide fiduciaries into legally acceptable conduct but also improves the ability of fiduciaries to defend their conduct if their actions are taken in reliance upon the legal advice. Failure to obtain legal advice with respect to legally complex issues, including the necessity and content of plan amendments, may constitute a breach of fiduciary duty.

Only qualified counsel with experience and an expertise in the subject area should be relied upon. Fiduciaries should not feel compelled to use the same counsel for all legal issues but should seek the most competent counsel reasonably available for the issue under consideration.

If a fiduciary meets resistance from other fiduciaries in seeking legal advice, the requesting fiduciary should persist. Such resistance may suggest that a problem exists that needs the critical review of independent legal counsel.

CONFLICTS OF INTEREST

One of the greatest sources of liability for fiduciaries is conflict of interest. If the fiduciary is an employee of the sponsoring organization, that fiduciary's loyalty to and financial interest in the sponsoring organization may color his or her decisions on behalf of the plan. Any decision by the fiduciary is subject to criticism as being primarily for the advantage of persons or entities other than the participants and beneficiaries of the plan.

Unless independent fiduciaries are selected, this inherent conflict of interest cannot be avoided. However, in recognition of this conflict, fiduciaries should exercise extraordinary caution to ensure that decisions and transactions are fair to the participants and the plan and that such fairness is documented and can be proved at a later date. For example, recommendations, appraisals, and analyses from independent advisors should be obtained in writing and retained. The analysis of alternatives should be thorough and documented, along with the reasons for selecting the preferred alternative.

This inherent division of loyalty is particularly problematic when the sponsoring organization fails to contribute to the plan as required. Fiduciaries must act in the sole interest of the plan and its participants when evaluating what, if any, action should be taken by the plan to enforce sponsor contributions. Independent advisors who are unaffiliated with the employer-sponsor should advise the fiduciaries of their duties, the relevant factors they may consider in making their decision, and their alternatives. If possible, only independent fiduciaries should participate in the decision. Fiduciaries should resist the temptation to postpone a decision in the hope that the sponsoring company will subsequently make the required contributions.

Frequently, delay in taking action only aggravates the situation. If delay is found to be in the plan's best interest, the reasons for that conclusion should be fully documented.

Another fairly common situation that is fraught with conflict-of-interest problems for the fiduciary/officer is the termination of an overfunded plan. Full compliance with the specific requirements for terminating a plan and obtaining a reversion of excess funds requires the assistance of qualified advisors. Even when the requirements of the law have been met and the benefit commitments of the plan have been secured for all participants and beneficiaries, such a transaction is often viewed by participants and beneficiaries as unfair. In that climate, challenges to fiduciary conduct are likely. A decision to terminate a plan and recapture excess funds should be carefully considered by independent fiduciaries if possible. The reasons for the decision should be well documented and forthrightly communicated to the participants, including an explanation of the reasons for the decision and the approvals by governmental agencies that will be necessary to implement the termination.

Self-dealing transactions must be avoided. This restriction applies not only to obvious self-dealing situations where an individual is directly involved on both sides of the transaction but also in more subtle situations. For example, if a fiduciary has a close relationship with a person dealing with the plan, the true independence of that fiduciary may be open to challenge. Even the appearance of self-dealing should be avoided. Potential conflict analysis should be incorporated into various plan procedures. For example, when selecting fiduciaries, advisors, or support staff for a plan, consideration should be given to the person's former and current business affiliations in light of the plan's operations and investments to determine if the candidate would be placed in an inherent or a potential conflict situation.

Transactions with a party-in-interest to the plan are also prohibited. Transactions are generally prohibited with persons providing services to the plan, an employer whose employees are covered by the plan, a union whose members are covered by the plan, and certain direct or indirect owners, officers, or partners of such persons. Fiduciaries should maintain and continually update a list of the plan's parties-in-interest through use of periodic questionnaires and other investigation. That list should be consulted for each transaction considered by the fiduciaries.

At a minimum, a list should be maintained identifying certain kinds of institutions or persons with whom the plan frequently deals who would be parties-in-interest to the plan, including banks, broker/dealers, and investment bankers.

When in doubt as to whether a conflict exists or whether a transaction is prohibited, advice from legal counsel should be obtained.

LOSS PREVENTION GUIDELINES FOR SPECIAL RISKS

Following are some loss prevention guidelines for certain particularly troublesome fiduciary risks.

Stock-Drop Litigation

Many 401(k) plans allow participants to purchase in their individual accounts securities of the sponsor company. Although this has been a common practice for years, a new breed of litigation against fiduciaries has emerged arising out of that employer stock ownership in plans. When the sponsor announces surprising adverse news and the market price of its securities takes a sudden drop, securities class-action lawsuits frequently are filed by shareholders against the company and its directors and officers, alleging misrepresentations and omissions of material facts before the sudden stock drop. However, in that situation, it is now common for a second type of class action to also be filed on behalf of plan participants who owned company securities in their individual plan accounts. This tandem lawsuit—frequently called an ERISA "tagalong" or "stock-drop" case—is brought against plan fiduciaries and alleges breach of ERISA fiduciary duties by failing to disclose truthful information to participants and/or allowing the participants to invest in the employer stock when the fiduciaries knew or should have known that stock was an imprudent investment.

The following summarizes a number of prevention concepts that can reduce the likelihood that an ERISA stock-drop claim will be filed and can enhance the defendants' ability to successfully defend such a claim if filed.

1. **Review plan terms annually to maximize protection.** Plan documents should be reviewed annually to ensure the documents provide the fiduciaries with maximum protection in light of the most recent statutes, case law, and regulatory developments. For example, if the plan allows participant-directed investments, the plan should have an express provision that relieves fiduciaries of fiduciary responsibility

for losses incurred as a result of a participant's investment instruction. Such a provision is authorized by Section 404(c) of ERISA and can be effective if the plan provides (i) diversified investment options; (ii) opportunities to transfer assets in the plan account; (iii) sufficient information to allow participants to make sound investment decisions; and (iv) notice to participants of the Section 404(c) provision. The plan can also, under certain circumstances, state that the employer's matching contribution to the plan must be made or invested in employer stock and that employer stock shall be an investment option for participants. This provision attempts to remove from the fiduciaries any discretion relating to the employer stock investment, thus reducing their exposure to claims for breach of their fiduciary duties with respect to investment decisions relating to that stock.

However, fiduciaries should not blindly follow such plan provisions if compliance with those provisions is inconsistent with prudent fiduciary behavior. For example, if the employer is in the zone of insolvency, the fiduciaries should not continue to allow participants to invest in employer stock notwithstanding a plan provision requiring this investment option. Thus, even if the plan requires inclusion of employer stock, the fiduciaries should periodically review the appropriateness of employer stock in the plan, applying a presumption of reasonableness in light of the plan provision. Factors to consider in that review include the current recommendations of investment analysts, the decisions by independent institutional managers regarding the employer's stock, and the extent of buying and selling by company insiders.

2. **Appoint independent fiduciaries.** One of the most problematic allegations in ERISA stock-drop lawsuits is that the plan fiduciaries had an inherent conflict of interest by serving as both a plan fiduciary and as an officer or a director of the sponsor company. Because of this dual capacity, plaintiffs argue that the plan fiduciaries took actions primarily for the benefit of the company rather than plan participants

and that plan fiduciaries knew but failed to disclose material, non-public information that injured plan participants.

To avoid (or at least minimize) the effect of those allegations, companies should consider appointing independent fiduciaries to manage and monitor the plan's investment in company stock. These independent fiduciaries should have no actual or perceived relationship with the company or its directors and officers and should have exclusive control over the investment-related decisions for the plan, at least with respect to investment in employer stock. Alternatively, company officials who typically do not have access to the company's non-public information could be designated investment fiduciaries, although such a practice invites an argument that the fiduciary in fact knew or should have discovered the non-public information by reason of his or her position with the company.

3. **Avoid inadvertent fiduciary status.** Frequently, ERISA stock-drop claims name as defendants not only the plan's named fiduciaries but also other directors, officers, and human resources personnel of the plan sponsor, as well as investment and administrative committee members. To avoid having individuals be inadvertently subjected to ERISA fiduciary duties, the company and the plan should tightly control the number of people who become involved in plan matters, and the responsibilities for each such person should be well-defined and understood. In addition, the plan sponsor should not be a named fiduciary or, if named, the company's fiduciary responsibility should be expressly delegated in the plan to an individual or a group of individuals other than the board of directors. Otherwise, the directors may be liable for improperly discharging the company's ERISA fiduciary duties.

4. **Use prompt and accurate communications.** The federal securities laws require a company to disclose material information to investors only at certain designated times, such as when an SEC filing is due or

when the company is purchasing or selling its own securities. In contrast, ERISA may require plan fiduciaries (including company officers) to disclose material information regarding the company on a more current basis if the information could reasonably be viewed as important to plan participants in making plan investment decisions. To avoid violating the insider trading rules under the securities laws, fiduciaries who are officers of the company should not selectively disclose information about the company only to plan participants but should disclose any material, non-public information to all investors and plan participants at the same time and as soon as possible after the fiduciary learns of the information.

In any event, all communications by plan fiduciaries to participants should be prompt, accurate, clear, and consistent with disclosures to other company constituents. Clever "spin" or other vague or confusing communications should not be tolerated. Instead, the communications should be easy to understand and convey the whole truth. Even unsophisticated participants should be able to readily understand the disclosed information. Bad news should not be understated, and good news should not be overstated.

5. **Encourage diversification of investments.** Consistent with sound investment concepts, company management and plan fiduciaries should encourage participants to diversify their investments and not include within their investment portfolios an unreasonably large percentage of company stock. An excessive concentration of an employee's investment portfolio in company stock can not only create unnecessary investment risk and engender ERISA claims but also may motivate employees to act inappropriately in order to artificially maintain or increase the company's stock price.

   Fiduciaries, however, should avoid providing specific investment advice or recommendations. Statements such as "this is the best investment option" or "I would invest my money in this" should be avoided.

6. **Eliminate company stock in plan.** There are clear benefits to employees' owning stock in the company, thereby aligning their interests with outside investors. However, as demonstrated by the recent wave of ERISA stock-drop claims, such a practice creates inherent and potentially large litigation risks. As a result, companies should periodically evaluate the risks and rewards of including company stock as an authorized investment option and as the employer's matching contribution under plans. Unquestionably, the safest strategy from a risk management perspective is to eliminate company stock from the plan.

Legal Compliance

A constant and challenging responsibility of fiduciaries is to ensure that the plan and trust documents and operations are in full compliance with all applicable laws. Because of the constantly changing legal requirements applicable to employee benefit plans, a comprehensive and continuing program to monitor legal developments is essential. It is desirable to periodically obtain an opinion of legal counsel regarding the conformity of the plan document and its operation, including compliance with the applicable statutory requirements and tax qualification provisions.

Regulatory filings and communications to plan participants must be accurate and complete. Before these documents are finalized, fiduciaries should personally review them and make necessary inquiry to satisfy themselves that the documents have been properly prepared. Communications to plan participants should be timely, easily understood, and forthright. Disclosure beyond the minimum statutory requirements is encouraged. Fiduciaries should also confirm that the plan documents contain provisions that would enable them to effectively deal with current business and economic developments, as well as issues that are likely to arise in the future. Examples include:

- Special interim asset valuation procedures in contemplation of large stock market drops.

- Reservation in the named fiduciary of the right-to-vote proxies following the appointment of an investment manager.

- Investment guidelines establishing either broad or limited authority for new, creative investment vehicles.

- Allowance of reasonable periods of time in which to execute investment instructions when participants elect such changes.

Participant Claims

Participant claims often arise from problems in plan administration. The denial of a benefit claim or payment of a lesser benefit than the participant believes is due may be a result of improper record keeping or inadequate communication of benefits to the participant. Fiduciaries should familiarize themselves with new regulations—such as the Department of Labor's (DOL's) 2000 revisions to the regulations governing claims procedures in employee benefit plans governed by ERISA—and should implement strategies for compliance. The fiduciary is ultimately responsible for failure to administer a plan pursuant to its terms. If these duties are delegated to a service provider, the governing contract should provide for indemnification of the plan for the provider's negligence.

As employees continue to move from one employer to another with increasing frequency, plan fiduciaries and administrators face increasing challenges to comply with the COBRA requirements regarding continuation of benefits. Clear and precise internal procedures need to define who has responsibility for COBRA compliance issues and how that compliance is administered and monitored.

Participant misunderstandings about benefits are best dealt with by continual and understandable communication. A vague or imprecise summary plan description has often resulted in the payment of benefits not due under the terms of the plan. Prompt, understandable responses to benefit claims would undoubtedly reduce the number of claims that are litigated.

Tender Offers

Fiduciaries face significant potential for liability when the plan holds stock of the sponsoring corporation and that corporation becomes the target of a takeover bid. From a purely financial standpoint, the fiduciaries arguably should tender shares of the target sponsor company that it owns because the tender price is invariably much higher than the then-market price. However, other factors, including the effect of the proposed takeover on the long-term viability of the plan and its participants, may be considered. In reality, the fiduciaries will likely be reluctant to tender the shares unless management of the target sponsor company supports the takeover bid. In that context, the fiduciaries may be perceived as foregoing enormous gains or creating enormous losses for the plan.

The following precautionary guidelines should be considered by fiduciaries when responding to a hostile tender offer for the target sponsor company:

1. **Independent experts.** The fiduciaries should retain independent, qualified experts, including attorneys, accountants, and investment advisors, to evaluate alternatives and offer advice. Experts that are generally consulted by the sponsoring company should not be used because of their likely conflict of interest.

2. **Thorough investigation.** The fiduciaries should make a thorough, well-documented investigation and analysis of all investment alternatives and the likely results of each. Among other things, the risk of loss, the opportunity for gain, the impact on the fulfillment of the plan's purposes, the resulting diversity and liquidity of plan assets, and

the accuracy and reasonableness of assumptions by experts should be carefully examined for each alternative.

3. **Documentation.** The fiduciaries should document all meetings, discussions, alternatives, investigations, analyses, expert opinions, and recommendations; relevant factors considered; and reasons for selecting certain options. Absent this documentation, the fiduciaries will later have difficulty proving the prudence and propriety of their actions in court.

4. **Independence.** Fiduciaries should not participate or appear to participate in any decisions by the target sponsor company with respect to responding to the hostile tender offer. Any fiduciaries who are active officers or directors of the sponsoring company should consider resigning as fiduciaries or disqualifying themselves from consideration of plan alternatives.

Employee Stock Ownership Plans (ESOPs)

An ESOP is a special type of employee benefit plan designed to invest primarily in securities of the sponsoring organization. Although legally recognized for many years, ESOPs became more popular in the mid-1980s as a result of tax law changes and corporate takeover activity. Nowhere is the inherent conflict of a fiduciary/officer more apparent than in the context of an ESOP.

Because of the potential for actual or perceived abuse of participants in an ESOP, fiduciary liability exposure is significant. It is imperative that any decision on behalf of the plan be made by or based upon advice from persons totally independent of the sponsoring organization. Fiduciaries must resist the strong temptation (and perhaps pressure) to use the shares held by the plan to further the interests of management to the possible detriment of participants.

If an ESOP becomes involved in financing a management-sponsored buy-out or opposing a hostile takeover of the sponsor company, an independent analysis on behalf of the plan and a thorough, well-documented investigation of all relevant information are essential. Expert advisors with no actual or perceived relationship with the sponsoring company should be retained and heavily relied upon. Truly independent and objective advice is essential for the fiduciary to respond appropriately in these situations.

Labor-management Plans

Labor-management plans (sometimes called Taft-Hartley plans) are formed pursuant to collective bargaining agreements and present several unique liability exposures that require specialized loss prevention efforts. The benefits provided by these plans are typically negotiated and set forth in collective bargaining agreements. Fiduciaries must promptly evaluate the effect on the plan of increased benefits promised by the collective bargaining agreement. The funding of the plan should ensure that long-term solvency of the plan is not jeopardized. Fiduciaries should promptly identify funding deficiencies and take steps to ensure that the plan will remain financially viable.

Fiduciaries representing unions frequently face the same significant conflicts of interest as employee fiduciaries when deciding how to respond to delinquent contributions by an employer. Aggressive collection of the contributions may encourage the employer-contributor to become non-union, although failure to aggressively collect contributions jeopardizes the interests of the plan. Fiduciaries should document the reasons for any delays in aggressive collection efforts.

Unique investment issues sometimes arise for fiduciaries of these plans. Frequently, strong pressure exists, or at least is perceived to exist, for "social investing" in ventures that may not yield the highest return or provide maximum security but that promise to create jobs or bestow other indirect benefits to plan participants and others. Management and labor trustees must balance their duty to prudently invest plan assets for the purpose of providing retirement benefits with the desire to make riskier investments perceived to provide more immediate or non-retirement benefits. Clear identification and documentation of the reasons for the selected investment should exist. If the reasons are non-financial, the fiduciaries should conduct a special investigation to evaluate the likely benefit that such an investment would have on the participants and weigh that benefit against the benefits available through a more financially lucrative investment.

Because labor-management plans are not subject to the unilateral control of one employer, the fiduciaries of those plans may be required to take actions that would be considered "settlor" in nature and thus not subject to ERISA fiduciary duties, if the actions related to a single employer plan. In other words, the important line between settlor and fiduciary functions in the context of labor-management plans is more blurred. To increase the likelihood that certain actions will be properly considered as settlor in nature, the labor-management plan and the collective bargaining agreement should not contemplate the plan trustees' acting as fiduciaries in carrying out activities that would otherwise be settlor in nature, such as amending the plan or the nature or level of benefits. Instead, the plan documents and collective bargaining agreement should either expressly disavow such activities as fiduciary functions or not address such activities.

Cash Balance Plan Conversions

Conversions of traditional defined benefit plans into cash balance plans have recently raised a number of issues. Although an employer's decision to convert a traditional defined benefit plan into a cash balance plan is not subject to ERISA's fiduciary standards, implementation and communication of the decision can nevertheless increase potential fiduciary claims. To avoid claims, fiduciaries should ensure that all plan communication materials regarding the conversion are accurate and identify and provide participants with the information needed to make informed decisions.

In addition, fiduciaries need to be certain the cash balance plan is designed and operates in compliance with very technical rules relating to these types of plans. Experienced and competent legal, actuarial, and other consulting advice is essential, and formal opinions from these experts confirming full compliance with ERISA standards should be obtained. In addition, any conversion should be structured to avoid decreasing vested accrued benefits under the prior defined benefit plan.

Fees to Service Providers

Fiduciaries inevitably hire various service providers for the plan. When the fees for those services are paid out of plan assets, fiduciaries should ensure that the fees are reasonable in light of the services provided. The service provider should be selected in part based upon the proposed fees by the provider. An express agreement with the provider should include a detailed description of the services to be performed and all fees and expenses to be charged under the agreement, including when and under what circumstances those fees can be increased during the engagement. Once a provider is selected, fiduciaries should also monitor the continued reasonableness of the fees being charged in light of the nature and quality of services being rendered.

Fiduciaries should be particularly wary of several fee practices:

1. **Bundled services.** Some providers offer a number of services for one fee. Under that arrangement, it is difficult to evaluate the reasonableness of the fees being paid for any particular service, and the aggregate fee may include services that the plan does not need or want. Where possible, such an arrangement should be avoided and the fee for each specific service should be identified and approved by the fiduciaries.

2. **Soft dollars.** Some service providers purport to provide a service for no cost, when in fact the cost of the service is subsidized by other inflated charges. This practice can complicate the fiduciaries' cost-

benefit analysis and may induce fiduciaries to use a service provider under the false impression that the plan is obtaining free services. This practice is most common with respect to investment managers who purport to provide "free" research and market data to the plans, when in fact the cost of that service is included in commissions charged by the investment manager for the execution of trades. By requiring the investment manager to separately itemize the charges and sources of payment, the fiduciaries can avoid having the plan unknowingly pay for services not required by the plan.

Blackout Periods

Plans occasionally must impose "blackout periods" during which plan participants are unable to change investments in their self-directed accounts in the plan. As evidenced by the highly publicized blackout in the Enron plans shortly before Enron's collapse, these blackouts can severely harm the participants under certain circumstances and can create the appearance of wrongdoing by the fiduciaries who imposed the blackout and determined its length. In response to those concerns, the Sarbanes-Oxley Act of 2002 imposed new requirements and prohibitions regarding plan blackouts. Some of the best practices relating to blackouts in light of the new legislation include:

- Where possible, any necessary blackout should be regularly scheduled and the time and length of the blackout period should be incorporated into the plan and disclosed to employees before they become participants in the plan.

- Any specially scheduled blackout should be arranged by the fiduciaries after considering the impact on participants and should be scheduled to minimize the length and consequence to the participants.

- Notice of any blackout should be communicated to all participants at least 30 days in advance, and the notice should include the reasons for the blackout period, an identification of the investments and other rights affected, the expected beginning date and length of the blackout period, and a statement advising the participants to evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify investments in their accounts during the blackout period.

- All directors and executive officers of the sponsor company should also be informed of the blackout period and prohibited during the blackout period from purchasing, selling, or otherwise acquiring or transferring any securities that they personally own in the sponsor company and that they acquired in connection with their service or employment as a director or executive officer.

Selection of Annuity Provider

ERISA fiduciary standards apply to the selection of annuity providers for the purpose of pension plan benefit distributions, whether upon separation from service or retirement of a participant or upon the termination of a plan. In selecting an annuity provider, a fiduciary should evaluate the following factors:

1. The quality and diversification of the annuity provider's investment portfolio.

2. The size of the insurer relative to the proposed contract.

3. The level of insurer's capital and surplus.

4. The lines of business of the annuity provider and other indications of an insurer's exposure to liability.

5. The structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts.

6. The availability of additional protection through state guaranty associations and the extent of their guaranties.

Special care must be taken in connection with terminations of overfunded pension plans. A fiduciary should avoid purchasing risky, lower-priced annuities in order to ensure or maximize a reversion of excess amounts that will be paid to the employer-sponsor. Conversely, a fiduciary should not purchase a risky annuity solely because there are insufficient assets in the plan to purchase a safer annuity.

Maximum Indemnification Protection

The sponsoring organization should provide for the benefit of its fiduciaries the maximum indemnification protection permitted by law in its articles of incorporation or bylaws. The direct indemnification of fiduciaries by a plan does not relieve them from liability from their ERISA-imposed duties. However, indemnification by the sponsoring organization or other body with appointment authority is permissible. Prototype indemnification provisions are often inadequate to provide maximum protection. In order to maximize indemnification rights, the indemnification provision:

- Should provide for indemnification to the fullest extent permitted by law.
- Should require, rather than merely permit, indemnification.
- Should require the advancement of defense expenses, subject only to an unsecured obligation to repay the expenses if a court subsequently determines the indemnification was not permitted.
- May shift the burden of proof to the sponsoring organization to prove that the fiduciary is not entitled to the requested indemnification.
- May require the sponsoring organization to reimburse the fiduciary for any expenses incurred in a claim against the plan or sponsoring organization for such indemnification if the fiduciary is successful in whole or in part.
- May provide that the fiduciary has a right to an appeal or an independent *de novo* determination of indemnification and entitlement.

- May expressly state that the indemnification rights constitute a contract, are intended to be retroactive to events occurring prior to its adoption, and shall continue to exist after the rescission or restrictive modification of the provision with respect to events occurring prior to that rescission or modification. Alternatively, a separate indemnification contract could be executed by the fiduciary and the indemnifying party.

- May permit the escrow of assets upon termination of a fiduciary sufficient to discharge the fiduciary's anticipated liabilities due to claims that exist or are threatened at the time of the termination.

To ensure adequate funding for any indemnification claim, the indemnification obligation may be secured by establishing a reserve fund, providing a guarantee, or purchasing a surety bond, letter of credit, or other similar financial instrument.

Fiduciaries should also require indemnification from all service providers to the plan.

Fidelity Bond

The plan is required to bond any fiduciary and all other persons who handle monies of the plan. Fiduciaries should independently determine the appropriate amount of these bonds because in most instances the statutory minimum amount may be insufficient to adequately protect the plan against potential dishonesty. Fidelity bonds reimburse the plan only for losses arising out of dishonesty and do not protect fiduciaries to the extent claims are made against them.

Fiduciary Liability Insurance

Fiduciary liability insurance transfers to the insurer the employer's financial risk of funding its obligation to indemnify fiduciaries. This is an important protection because indemnification from the sponsoring organization is generally considered, by itself, inadequate protection against fiduciary liability because, among other reasons, indemnification may not be available for the following reasons:

- The employer may become insolvent or may not have sufficient available cash flow to pay the losses and expenses incurred by the fiduciary.

- Either the applicable law or the internal indemnification provisions of the employer or plan may be modified to limit or prohibit the expected indemnification.

- The composition or attitude of the employer's governing body or the plan's fiduciaries may change so that the persons who must approve the indemnification are no longer sympathetic to the fiduciary and therefore do not make the necessary findings or resolutions to authorize the indemnification.

Because of public policy considerations and statutory limitations, some claims may be insurable but not indemnifiable. For example, settlements and judgments in suits brought by or on behalf of the employer are not indemnifiable in many states, and loss arising from violation of the federal securities law may not be indemnifiable, although such items may be insured.

In some states, the employer is not legally permitted to indemnify fiduciaries.

Because fiduciary liability insurance purchased by a plan must by law permit the insurer to recoup its loss from the fiduciary if a breach of fiduciary duty occurs, the sponsoring organization, rather than the plan, should purchase the insurance. As an alternative to a separate fiduciary liability insurance policy, fiduciaries may be insured under the sponsoring organization's directors and officers liability policy or other type of insurance policy. Such joint coverage should be carefully examined to ensure that the intended coverage for fiduciaries in fact exists and to evaluate the effect of erosion of the limits of liability by combining two different insurance programs into one policy.

Fiduciary liability insurance is unique in nature and creates complex legal, underwriting, and management issues that are difficult to identify and analyze without the assistance of knowledgeable experts.

Administrative Remedies

Plan documents should provide an administrative review process for disputes and require plan participants to exhaust their administrative remedies before filing a lawsuit. Although some courts have not enforced such provisions if a participant's claim is based on a statutory right rather than a contractual right, administrative review proceedings that offer a denied claimant the opportunity for a hearing on his or her claim will often prevent more-expensive and time-consuming litigation.

Document Retention Program

To guarantee that valuable documents are not destroyed and that potentially harmful documents are not retained, a document retention program should be established. This program should define the administrative procedures for retaining documents relating to the plan and actions of the fiduciaries, including financial and legal documents, participant records, and other files of the plan.

The document retention program should include procedures for periodic review of documents to determine those that should be retained and those that should be destroyed. This determination should be made in light of ERISA, state laws, and evidentiary rules that may apply, the degree to which the documents are superfluous or unnecessary, and the possibility that the documents may be misconstrued or confusing. When in doubt, a document should be retained. Such a program should be implemented not only by the plan but also by individual fiduciaries with respect to documents in their personal files.

Compliance Audit

A plan may use an ERISA compliance audit to inspect and evaluate the overall condition of the plan and its operations. The audit should be conducted by a highly experienced person of strong professional standing. Among other things, the audit may include an investigation of document adequacy, tax compliance, and accurate communication to participants and government authorities; an assessment of plan administration standards, procedures for ensuring the maintenance of correct and protected records, the existence of high standards of management performance, and the degree of protections against prohibited self-dealing and party-in-interest transactions; and a qualitative determination as to the security, performance, and diversification of the plan's asset portfolio.

In addition to identifying potential problem areas, a compliance audit demonstrates the exercise of sound business judgment by fiduciaries and emphasizes to all persons affiliated with the plan the necessity for compliance with all legal requirements at all times and the importance of preventative planning.

Voluntary Fiduciary Correction Program

The DOL's Voluntary Fiduciary Correction Program encourages remedial compliance efforts by parties who have engaged in certain violations of the fiduciary rules with respect to qualified and 403(b) plans. To be eligible to participate in the program, a fiduciary may not currently be under investigation by the DOL. Examples of transactions that are eligible for the Voluntary Fiduciary Correction Program include delinquent participant contributions to pension plans, loans with parties-in-interest, and benefit payments based on improper valuation of plan assets.

Participant-directed Individual Account Plans

Plan fiduciaries may be relieved from liability for investment losses if those losses result from a participant's or beneficiary's exercise of control of plan assets in an individual account plan under the following circumstances:

- A participant can choose from a broad range of investment alternatives that consist of at least three diversified investment alternatives, each of which has materially different risk and return characteristics.
- A participant can give investment instruction with a frequency that is appropriate in light of the market volatility of the investment alternatives but not less frequently than once within any three-month period.
- A participant can diversify investments within and among investment alternatives.
- A participant can obtain sufficient information to make informed investment decisions with respect to investment alternatives available under the plan.

Participants who fail to make any plan or investment elections may still participate in a self-directed 401(k) plan through a "negative" or "default" election provision in the plan. Fiduciaries should continue to send communications and disclosures to those participants at the same time and to the same degree as communications and disclosures to more active participants, so the passive participants cannot later contend they did not know relevant information. These communications should include a summary of the investments held in the participants' accounts and invite the participants to contact the fiduciaries if the participants have questions or would like to change the investments.

Avoiding *de novo* Standard of Review

Courts will generally apply a *de novo* standard of review of fiduciary actions with respect to benefit denials and claims of plan participation. However, fiduciaries can avoid this stringent standard of review by ensuring that the plan document expressly grants the fiduciary discretionary authority to construe and interpret the plan and to administer its terms and provisions. Most employee benefit plans will contain this language. However, welfare plans may not. Fiduciaries should ensure that this language is incorporated into welfare plan documents, which in many instances may consist only of a summary plan description.

CONCLUSION

The importance of adopting a fiduciary loss prevention program cannot be overstated. Fiduciaries must make decisions about other people's money—money that may be earmarked for important life expenditures such as health care, retirement, and education. Fiduciaries are expected to act in the sole interest of the plan and its participants, who are naturally sensitive to perceived mistakes and misjudgments. In today's litigious society, people who perceive they have been wronged react with lawsuits that can cost millions of dollars to defend and settle.

Fortunately, loss prevention—applied judiciously, methodically, and with guidance from legal experts—is a relatively inexpensive method of protection.

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