Defined Contribution Plans with Individual Accounts-
Fiduciary Best Practices
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The legal and practical scrutiny a fiduciary undergoes is tremendous. The ERISA fiduciary is required to conduct an ongoing investment and benefit monitoring process that is, in procedure and substance, more complex and sophisticated than was previously required by law. This evolution is entirely consistent with the ERISA § 404(a)(1)(B) requirement of the “care, skill, prudence, and diligence under the circumstances then prevailing” prudent expert fiduciary standard of care process.

Furthermore, we believe the Foundation for Fiduciary Studies (www.FI360.com) may well establish the national standards by which not only professional trustees, but all financial intermediaries who provide professional investment advice at a fiduciary standard of care will be measured [Trone, D., Lynch, R., Rickloff, M., and Frommeyer, A., Prudent Investment Practices: A Handbook for Investment Fiduciaries, Foundation for Fiduciary Studies, Pittsburgh, PA, (2004)].

The Foundation for Fiduciary Studies has authoritatively and definitively established practice standards that are increasingly accepted by the industry experts as necessary to fulfill ERISA fiduciary responsibilities based on statutes, case laws and regulatory opinion letters [Reish, F. and Ashton, B., “Legal Memorandums to Accompany the U.S. Edition of Prudent Practices Fiduciary Handbook,” Foundation for Fiduciary Studies, Pittsburgh, PA, © 2002-2006]. The fiduciary practice standards have been organized into a prudent process comprised of six financial services:

1. Asset/liability study,
2. Investment policy,
3. Strategic asset allocation,
4. Manager search and selection,
5. Performance monitor, and
6. Tactical asset allocation.

Each of these six financial services adds value in its own right, but when they are aggregated into a comprehensive investment process, they constitute an extraordinary level of investment and administrative counsel.

In addition, a national certifying body now exists to conduct independent reviews of fiduciary practices. Further information about fiduciary certification can be obtained at the Centre for Fiduciary Excellence, or CEFEX [www.CEFEX.org].

In addition, the ERISA § 402(b)(1) “Funding Policy and Method” requirement means that the plan fiduciaries must examine more than just investment quality. How can the fiduciary seeking to deliver best practices prudently manage if there is no funding policy and retirement benefit goal? The answer is that they can’t! Plan fiduciaries must look at the actuarial and benefit funded status of each participant in an individual account plan.

Many of the Foundation for Fiduciary Studies best practices must be delivered at the participant level. In particular, the following eight best practices are useful and relevant only at the participant level in an individual account defined contribution plan:

Practice A-1.2
Investments are managed in accordance with applicable laws, trust documents, and written investment policy statements (IPS).

Practice A-2.1

An investment time horizon has been identified for each client.

Practice A-2.2

A risk level has been identified for each client.

Practice A-2.3

An expected, modeled return to meet investment objectives has been identified.

Practice A-2.4

Selected asset classes are consistent with the risk, return, and time horizon.

Practice A-2.5

Selected asset classes are consistent with implementation and monitoring constraints.

Practice A-2.6

There is an IPS which contains the detail to define, implement, and monitor the client’s investment strategy.

Practice A-3.1

Each client’s investment strategy is implemented in compliance with the required level of prudence.

These eight practices emerge from four basic ground rules to deliver a prudent ERISA process:

- Duty of loyalty to participant,
- Implementation of funding policy and benefit goal,
- Prudent process activity at client (participant) level, and
- Acceptance of fiduciary status with accompanying high standard of care.

In 2008, the United States Supreme Court issued a unanimous decision in LaRue v. DeWolff, Boberg & Associates [128 S. Ct. 1020 (2008)], which provided that ERISA authorizes individual defined contribution plan participants to sue for fiduciary breaches that impair the value of plan assets (i.e., their future retirement benefit) in their individual plan accounts. The LaRue case shows the importance of monitoring and delivering fiduciary care at the participant level, rather than just the plan level.

This holding has important implications for future ERISA litigation activity, and the individuals’ claims potentially present significant liability insurance coverage issues for plan sponsors. The analysis embodied by the Court’s majority opinion (written by Justice Paul Stevens) analysis turns on the view that, by contrast to the era when ERISA was first enacted and defined benefit plans predominated, “defined contribution plans dominate the retirement scene today.”

The circumstances for an individual participant in a defined benefit plan, Justice Stevens wrote, are quite different than under a defined contribution plan because misconduct relating to a defined benefit
plan would not affect any one individual’s plan interest unless the misconduct caused a default of the defined benefit plan itself. Justice Stevens wrote that:

For defined contribution plans, however, fiduciary misconduct need not threaten the solvency of the entire plan to reduce benefits below the amount that participants would otherwise receive. Whether a fiduciary breach diminishes plan assets payable to all participants and beneficiaries, or only to persons tied to particular individual accounts, it creates the kind of harms that concerned the draftsmen of the ERISA’s liability provisions.

After LaRue, it is clear that the Foundation for Fiduciary Studies best practices must be delivered at the participant level, as well as the plan level.