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The Fiduciary Duty to Ask for Help

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Fiduciaries are held to the highest legal standard. Where they are unsure of their expertise, fiduciaries must seek the advice of experts and carefully evaluate the advice given.

ERISA holds plan fiduciaries to a high legal standard ... the responsibilities of fiduciaries have been described as "the highest known to the law." [*Donovan v. Bierwirth*, 680 F.2d 263, 272 (2d Cit. 1982)] Obviously, not all fiduciaries have the skills needed to satisfy these high standards. Fortunately, ERISA permits fiduciaries, and in fact requires them, to get help when they need it.

This article explains the requirement that fiduciaries seek expert advice when they are not qualified to fulfill their ERISA obligations, as well as factors that should be considered when choosing an advisor or consultant to help select and monitor investments.

Responsibility for Plan Investments
A key fiduciary responsibility for participant-directed plans is the prudent selection and monitoring of plan investments. The Preamble to the final ERISA Section 404(c) regulation explains:

The act of designating investment alternatives ... is a fiduciary function.... All of the fiduciary provisions of ERISA remain applicable to both the initial designation of investment alternatives and investment managers and the ongoing determination that such alternatives and managers remain suitable and prudent investment alternatives for the plan. Therefore, the particular plan fiduciaries responsible for performing these functions must do so in accordance with ERISA.

As the Preamble further explains "... the plan fiduciary has a fiduciary obligation to prudently select such vehicles [for example, mutual funds], as well as a residual fiduciary obligation to periodically evaluate the performance of such vehicles to determine, based on that evaluation, whether the vehicles should continue to be available as participant investment options."

ERISA Section 404(a) requires that fiduciaries performing such duties act "for the exclusive purpose of providing benefits" and that they manage their plan's investments in accordance with the "prudent man rule." Under the prudent man rule, fiduciaries must use "the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." In the context of participant-directed plans, this means that the standard is that of a *hypothetical* person who is knowledgeable about selecting investments for participants to direct for the purpose of accumulating retirement benefits. For this reason, it is sometimes referred to as the "prudent expert rule." To satisfy that standard, fiduciaries should engage in both substantive and procedural prudence. That is, they should determine what information is material and relevant to their decision; gather, examine, and understand that information; and then make an informed decision based on their findings. [*See, e.g.*, DOL Reg. § 2550.404a-1, "Investment Duties."]

Courts have found that, to meet these standards, fiduciaries have an affirmative legal obligation to investigate the merits of any investments. In *Howard v. Shay*, the court said, "To enforce [ERISA's fiduciary duties], the court focuses not only on the merits of the transaction, but also on

the thoroughness of the investigation into the merits of the transaction." [100 F.3d 1484, 1488 (9th Cir. 1996)] In another case, the court stated that "[T]he most basic of ERISA's investment fiduciary duties [is] the duty to conduct an independent investigation into the merits of a particular investment." [*Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983)]

Expert Assistance When Needed

Although fiduciaries are held to the standard of a knowledgeable investor, they are not required to have the experience or qualifications that such a person might have. The court in *Harley v. Minnesota Mining and Manufacturing Company* explained that the law "does not impose a rule that fiduciaries be 'experts' on all types of investments they make." [42 F. Supp. 2d 898, 907 (D. Minn. 1999)] However, if fiduciaries lack the ability to manage their plan's investments prudently, they must get help. The Department of Labor (DOL), as well as a number of courts, has taken the position that fiduciaries who are not qualified to fulfill their duties are legally required to seek assistance from competent sources. The DOL states: "Unless they possess the necessary expertise to evaluate such factors, fiduciaries would need to obtain the advice of a qualified, independent expert." [DOL Reg. § 2509.95-1(c)(6)] In Liss v. Smith, the court said, "where the trustees lack the requisite knowledge, experience and expertise to make the necessary decisions with respect to investments, their fiduciary obligations require them to hire independent professional advisors." [991 F. Supp. 278, 297 (S.D.N.Y. 1998)]

Courts have recognized the use of experts to satisfy fiduciary responsibilities. In *Martin v. Feilen*, the court stated "courts should look closely at whether the fiduciaries investigated alternative actions and relied on outside experts before implementing a challenged transaction." [965 F.2d 660, 671 (8th Cir. 1992)] Additionally, the court in *Bisceglia v. Bisceglia* stated, "Although reliance on an adviser will not immunize a [fiduciary's] actions, it is a factor to be weighed in determining whether a trustee breached his or her duty." [17 E3d 393 (9th Cir. 1994)]

Merely hiring an advisor is not enough. The advisor must be prudently selected and monitored, and the advice must be carefully evaluated before being relied upon.

Evaluation of Expert Advice

Fiduciaries may not rely blindly on the investment advice they receive. Instead, they must review, evaluate, and understand the advice. As stated in *Howard v. Shay*, "The fiduciary must (1) investigate the expert's qualifications ... (2) provide the expert with complete and accurate information ... and (3) make certain that reliance on the expert's advice is reasonably justified under the circumstances." [100 E3d 1484, 1489 (9th Cir. 1996)] The court in *Donovan v. Mazzola* held that a fiduciary "is not justified... in relying wholly upon the advice of others, since it is his duty to exercise his own judgment in light of the information and advice which he receives." [716 F.2d 1226 (9th Cir. 1983)] After reviewing the advice provided by their experts, fiduciaries must determine whether that advice is well-founded and is appropriate for their plan and, if so, take measures to implement the advice.

Selection and Monitoring of Experts

In addition, fiduciaries are required to engage in prudent processes when selecting and monitoring competent advisors (which, for investments, might include investment advisors, consultants, and brokers). The court in *Bussian v. RJR Nabisco, Inc.*, explained: "whether a fiduciary's reliance on an expert advisor is justified is informed by many factors, including the expert's reputation and experience, the extensiveness and thoroughness of the expert's investigation, whether the expert's opinion is supported by relevant material, and whether the expert's methods and assumptions are appropriate to the decision at hand." [223 R3d 286, 301 (5th Cir. 2000)]

A number of court cases have analyzed the process and criteria for selecting investment advisors and managers under ERISA. [*Whitfield v. Cohen*, 682 F. Supp. 188, 193 (S.D.N.Y. 1988); Arizona State Carpenters Pension Trust Fund, D. Ariz., No. CIV 89-0693 PHX RGS, settlement 1/2/94; Chao v. Legino, D. Ore., No. 02-440, settlement 4/4/02.] The criteria considered in those cases are informative about the requirements for prudently selecting experts

to advise plan fiduciaries. The following list is drawn from these cases and other sources:

1. *Is the expert qualified?* Fiduciaries are required to select and monitor advisors prudently. As stated in Liss v. Smith: "Failure to utilize due care in selecting and monitoring a fund's service providers constitutes a breach of the trustee's [i.e., the appointing fiduciary's] fiduciary duty." [991 E Supp. 278, 297 (S.D.N.Y. 1998)] In selecting the advisors, fiduciaries should consider whether the advisor has the investment credentials, experience, and expertise to warrant being considered an expert. For example, Whitfield [682 F. Supp. at 193] focused on the advisor's:

a. Experience with other ERISA plans;
b. Education credentials;
c. Registration with appropriate regulatory authorities;
d. Reputation;
e. References;
f. Past performance with investments of the type contemplated.

2. *Does the expert provide quality services that are tailored to the plan?* Fiduciaries are required to determine whether the investments are suitable and appropriate for the needs of the plan and its participants. As stated by the *Liss v. Smith* court: "[fiduciaries] have an obligation to ... select the provider whose service level, quality and fees best matches the fund's needs and financial situation." [991 E Supp. 278, 300 (S.D.N.Y. 1998)] For example, fiduciaries should ensure that their expert will take into account the investment abilities of the participants and will give proper consideration to the plan's needs.

3. *Is the expert independent?* Courts have emphasized the importance of the independence of the expert. The court in *Gregg v. Transportation Workers of America International* stated: "One extremely important factor is whether the expert advisor truly offers independent and impartial advice." [343 F.3d 833, 841 (6th Cir. 2003)] While fiduciaries are entitled to rely on the expertise of their advisors if the advisors are qualified, **the courts appear to permit greater reliance on the advice of independent investment experts whose compensation is not affected by the advice given**. Stated slightly differently, if the compensation of the expert can be affected by the advice given, then prudence would require that the fiduciaries understand the nature and amount of that compensation and take it into account in evaluating the advice rendered.

4. *Does the expert provide full disclosure of fees and expenses, for all investments?* **Fiduciaries are required to know all expenses that are being paid by the plan, directly or indirectly, and to determine if they are reasonable** (that is, whether the expense is competitive in the marketplace and whether the plan and its participants receive value commensurate to the cost). [ERISA §~ 404(a)(1)(A)(ii), 406(a) (1) (C), and 408(b) (2)] They are not required to choose the least expensive services, but rather should ensure that they are getting adequate value for the plan's money. In explaining this requirement, the DOL has said, "employers must... ensure that fees paid to service providers and other expenses of the plan are reasonable in light of the level and quality of services provided." [A Look at 401(k) Plan Fees, U.S. Department of Labor, Employee Benefits Security Administration] To ensure compliance, fiduciaries should obtain, and the advisor should offer, written disclosure of all compensation and other payments, direct or indirect, related to the investments being recommended.

Of course, fiduciaries must also evaluate the costs and fees associated with the investment services of the person advising on the investments, who may be an investment advisor, broker, or consultant. **The first step is for the fiduciaries to obtain complete information about all payments, direct or indirect, being made to that person, whether by the plan or by a third party (e.g., the mutual fund complex, an insurance company, or a broker-dealer). T**he second step is to evaluate that information and determine whether the plan is receiving adequate value for the cost. A key factor for that analysis is the cost of a similar service in the marketplace. For

example, it would usually be imprudent to pay significantly more than the price of comparable investments or services from another source.

5. *How is the expert being paid for his or her services?* Fiduciaries should make sure that a prohibited transaction does not occur as a result of the manner in which the expert is paid. Under ERISA Section 406, fiduciaries have a duty to avoid prohibited transactions. Under ERISA, the most likely prohibited transaction would be that the advisor (for example, a broker or an investment advisor) gives conflicted advice (advice that results in the payment of variable or undisclosed compensation). [ERISA §SS 406(b) and 408(b)(2)] In order to avoid these prohibited transaction issues, the advisor should be independent (that is, not affiliated with, or compensated by, a provider) or should **receive level compensation** (that is, compensation that does not vary based on the funds recommended by the advisor).

Conclusion

It is important for fiduciaries to understand their legal responsibilities for plan investments, the requirement to seek expert advice, and the degree of reliance that can be placed on the advice given by experts. Fiduciaries must prudently select and monitor their advisors and consultants. They may not blindly rely on advice received. Instead, fiduciaries must evaluate and understand the advice and information provided, and, if they agree with that advice, follow it.

Additionally, to protect themselves and to maintain the records required by ERISA, fiduciaries should obtain a written report of the analysis and conclusions of the advisor. That report, together with other information considered by the fiduciaries, should be retained in the plan's due diligence files.
