The 3 Biggest Mistakes Fiduciaries Make

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Here are, in my estimation, the three biggest mistakes fiduciaries make.

Not knowing they are fiduciaries.

As noted above, a significant – and apparently growing — number of individuals who are, in fact, plan fiduciaries are oblivious to that reality. The reasons for that are varied, though the Alliance Bernstein survey suggests that knowledge gap is wider among those who serve on a plan committee than with those who have primary responsibility for the plan.

Of course, fiduciary status is based on one's responsibilities with the plan, not a title. Simply stated, if you have discretion in administering and managing the plan, or if you control the plan's assets (such as choosing the investment options or choosing the firm that chooses those options), you are a fiduciary to the extent of that discretion or control. If you are able to hire a fiduciary, you're almost certainly a fiduciary.

Speaking of committees, if you're responsible for selecting those who are on the committee(s) that administer the plan, you're a fiduciary. Not to mention if you happen to be on a committee that makes decisions regarding the plan's assets…

Not knowing the liability that comes with being a plan fiduciary.

ERISA fiduciaries are personally liable, and may be required to restore any losses to the plan or to restore any profits gained through improper use of plan assets. That's right, the legal liability is personal (you can, however, buy insurance to protect against that personal liability — but that's not the fiduciary liability insurance some have in place, nor is it typically covered by your standard corporate director liability insurance).

What does that liability mean? Consider that, in the Enron case, the outside directors and committee members settled for about $100 million, most of which was paid by the fiduciary insurer. However, the individuals also had to pay approximately $1.5 million from their own pockets.

And all fiduciaries have potential liability for the actions of their co-fiduciaries. So it's a good idea to know who your co-fiduciaries are — and to keep an eye on what they do, and are permitted to do.

Thinking that they can outsource their fiduciary liability.

Even when they aren't fully aware of their liability exposure — and certainly once they are — plan fiduciaries have a strong interest in shielding themselves from the consequences of that exposure. They often think that by hiring another plan fiduciary — and frequently that's a financial advisor — they have managed to absolve themselves from that responsibility.

As it turns out, ERISA has a couple of very specific exceptions; more precisely, ways in which you can limit — but not eliminate — your fiduciary obligations. One exception has to do with the specific decisions made by a qualified investment manager — but even then, the plan fiduciary remains responsible for the prudent selection and monitoring of that investment manager's activities on behalf of the plan.

The second exception has to do with specific investment decisions made by properly informed and empowered individual participants in accordance with ERISA section 404(c). Here also, even if the plan meets the 404(c) criteria (and it is by no means certain it will), the plan fiduciary remains responsible for the prudent selection and monitoring of the options on the investment menu.

It is important to remember that ERISA's "prudent man" rule is a standard of care, and when fiduciaries act for the exclusive purpose of providing benefits, they must act at the level of a hypothetical knowledgeable person and must reach informed and reasoned decisions consistent with that standard. Fiduciaries who are concerned that they fall short of that standard — and let's face it, many, perhaps most, are placed in those roles without training — may want to look to the counsel of the Department of Labor, which has said that "[l]acking that expertise, a fiduciary will want to hire someone with that professional knowledge to carry out the investment and other functions."

Doing so may not insulate you from all liability — but turning to experts is not only prudent, it surely minimizes the likelihood of making big mistakes.