SCHNEIDER DOWNS
Wealth Management

Seven Ways to Reduce Fiduciary Liability

In 2020, nearly 100 lawsuits alleging breach of fiduciary duty were filed. And with the number of 401(k) lawsuits on the rise targeting plans both large and small, sponsors are well-advised to consider taking additional meaures to mitigate fiduciary risk where practicable. Here are a few to consider.

1. Create and follow an IPS. While not an ERISA requirement, an investment policy statement (IPS) is considered a best practice according to Department of Labor (DOL) guidance. Among other things, it outlines how the organization will maintain and follow prudent processes for selecting and monitoring investments and oversee the performance of third-party providers. However, be advised that failure to follow IPS provisions can also expose an organization to increased risk, so careful crafting of IPS language is crucially important.
2. Outsource fiduciary responsibilities. While a 3(21) fiduciary acts in an advisory capacity, plan sponsors can hire a 3(38) fiduciary to maintain full authority and discretion over investments and take on the liability for managing them on a regular basis. Sponsors, however, must still conform to ERISA standards and follow a prudent process when engaging a 3(38) fiduciary (including monitoring them on an ongoing basis).
3. Obtain fiduciary liability insurance. This type of coverage is designed to protect companies from investment mismanagement claims and fiduciary legal liability. Such policies can protect both the organization as well as named fiduciaries, covering legal costs in the event of a 401(k) lawsuit. With the recent escalation of litigation, fiduciary liability insurance costs have also been on the rise, along with greater limitations in coverage.
4. Document, document, document. Keep detailed records of the prudent processes your company follows, from investment selection to fee benchmarking to ongoing fiduciary education and training. This documentation can strengthen your case in the event of a lawsuit.
5. Meet the safe harbor requirements of ERISA Section 404(c). This provision offers a "safe harbor" which if met relieves plan sponsors and fiduciaries from liability for losses arising from participant-directed investment. But to qualify, the plan must satisfy several a myriad of requirements pertaining to matters such as investment options, plan design and administration, as well as participant disclosures. Luckily the majority of these responsibilities are taken care of by top tier recordkeepers and/or third party administrators.
6. Take advantage of QDIA protections. In Section 624 of the Pension Protection Act of 2006, the DOL established the qualified default investment alternative (QDIA) safe harbor that allows for default investments to be made on behalf of participants who fail to make investment elections. QDIAs can include a target date fund, balanced fund or professionally managed account. Other regulatory requirements must also be satisfied to enjoy safe harbor relief from fiduciary liability for QDIAs, including the use of prudent QDIA selection criteria, participant notification, and regular monitoring of investment performance.
7. Class-action waivers and arbitration agreements. These plan document provisions require participants to undertake fiduciary breach litigation on an individual basis and prohibit the filing of legal actions in court (versus arbitration). Ideally, such clauses are included at the inception of the plan, as when added as amendments, the sponsor may have to later demonstrate that participants were

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made aware of the change. In cases where employees have already separated from the company, this may prove difficult.

Don't assume your plan is too small to be vulnerable to litigation risk. Creating layers of protection based on plan design features, documentation and adherence to prudent processes, fiduciary outsourcing and insurance coverage can help mitigate fiduciary liability.