Corporate Capital Resources LLC

A Couple of Pages on Fiduciaries, ESOPs, ERISA and Other Creatures of the Code

Under the Employee Retirement Income Security Act of 1974 ("ERISA"), the federal statute governing employee retirement plans, a fiduciary includes anyone who exercises discretionary control over plan management or plan assets, or who gives paid investment advice to the plan. Those meeting this description must act within the fiduciary standards set forth in ERISA: they must follow the plan documents, act prudently, act solely in the interest of plan participants, act for the exclusive purpose of providing benefits to plan participants and beneficiaries, and diversify plan investments. Employee Stock Ownership Plans ("ESOPs") are specifically exempted from the latter investment diversification requirement and in fact are mandated to be primarily invested in employer securities."

The Department of Labor has asserted that the positions of plan administrator and plan trustee, by their very nature, carry fiduciary status. Court rulings have made it clear that anyone exercising the functions of a fiduciary falls within the fiduciary standards of ERISA. The essence of a fiduciary, however, is discretion; when someone merely performs non-discretionary functions, no fiduciary status arises. A person may be a fiduciary for some purposes and not for others. Thus, a sponsoring employer may serve as plan administrator while engaging in other functions--such as adopting plan amendments--that are not governed by fiduciary standards.

In drafting the ESOP provisions of ERISA, Congress intended to encourage employers to provide their employees with an equity interest in their company. To promote this goal, Congress carved out exceptions to certain fiduciary duties in the case of an ESOP.

For example, ERISA provides that an ESOP fiduciary will not violate the duty to diversify plan investments by reason of his investment in employer securities. This exception also applies to other eligible individual account plans, as defined in ERISA, such as 401(k) plans.

An ESOP is required, under both ERISA and the Internal Revenue Code, to be primarily invested in employer securities. If the plan document for either an ESOP or a 401(k) plan requires the fiduciary to maintain an investment in employer securities, the fiduciary must comply unless by doing so he would violate a provision of ERISA, such as his duty to prudently invest the plan's assets. Accordingly, while language in a plan document requiring an investment in employer securities will provide some protection to the plan fiduciary, such protection is not absolute.

The major liability-related consideration for fiduciaries emerges from the fact that ERISA fiduciaries can be personally liable for their actions. That is, a fiduciary breach can be required to be compensated by the responsible fiduciary from personal funds.

When a prudent investment decision is an issue relating to the investment in the stock of the sponsoring employer, the fiduciary need not have weighed that investment against other available investments. Instead, the fiduciary may take into account the stated purpose of an ESOP to invest primarily in employer stock. Even when employer stock might be expected to underperform other available investments, the investment decision is not per se imprudent.

Recent circuit courts of appeals rulings that have directly addressed the issue interpreted ERISA as providing an additional protection to an ESOP fiduciary. These courts have said that ERISA grants a presumption of prudence to an ESOP fiduciary that acquires or holds employer securities.

A director, substantial shareholder, and/or corporate officer are almost certainly fiduciaries to any plans the company sponsors. Other shareholders and employees may be fiduciaries if they exercise any discretionary control of the plan's assets.

An officer or shareholder serving as trustee is a fiduciary probably not only as custodian of the assets but as an investment manager as well.

One can delegate many of the day to day tasks of operating a plan to third-party administrators or committees of employees or bank trust departments (and they may assume some fiduciary liability by accepting), but the named fiduciary responsibility remains with the corporation and its board of directors.

When a plan assigns investment discretion to one fiduciary and requires the plan trustee to follow the decision maker's instructions, the trustee may follow these instructions--so long as they comply with ERISA--without violating its obligations as a fiduciary. Such a "directed trustee" is not obligated to look behind the instructions it receives, provided that the instructions do not violate ERISA.

Any trustees should always view themselves as acting independently for the benefit of the plan and document extensively their interactions with the Board of Directors and the independent appraiser on behalf of the ESOP.

A good resource to read is David Ackerman's booklet: "Questions and Answers Regarding the Duties of ESOP Fiduciaries." Available from the National Center for Employee Ownership. www.nceo.org.

As a general rule, in the opinion of this observer, it is difficult to impossible to comply with every jot and tittle of ERISA. However, the overall prudent fiduciary who documents all actions and makes use of knowledgeable advisors will be on pretty solid ground. The few difficulties encountered by fiduciaries are derived from failures to consult skilled practitioners relative to valuation, appropriate legal documentation, record keeping related to plan administration and the like. There is always risk – whether crossing the street or purchasing stock for an ESOP. Fiduciaries are expected to properly and primarily assess risks for the benefit of their plan participants – and, incidentally, for themselves.

The above summary is a general educational discussion and must not be construed as accounting, investment or legal counsel. Appropriate professionals should be engaged before acting on any of the legislation summarized here.