



Share the Love; Establish an Investment Committee

By Robert E. Jamison, CLU, CFP®, AIFA®

With class action lawsuits against 401(k) Plan's on the rise, how does one limit their personal liability?

According to *LAW.COM*, the St. Louis law firm of Schlichter, Bogard & Denton has filed thirteen lawsuits against Fortune 1000 companies. Northrop Grumman, Exelon, Lockheed Martin, International Paper, and United Technologies are among those that have been targeted for breaches in fiduciary duties to their plan participants. Prospectively, there are over a dozen more that will be filed, according to Rick Meigs, President, *401(k)helpcenter.com*.

These lawsuits seek to establish that plan sponsors and associated fiduciaries violated their duty of “prudently managing” plans and their assets. The question then becomes, how do plan sponsors best manage personal liability (short of terminating their plan) associated with 401(k) plans.

ERISA is clear about the *results* that plan fiduciaries must achieve:

1. Manage the plan for the exclusive purpose of providing benefits to plan participants and beneficiaries.
2. Manage the plan “with 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 like character and like aim. In short, fiduciaries are held accountable as a “prudent expert.”
3. Diversify the plan's investments so as to minimize the risk of large losses, unless it is clearly prudent not to do so.
4. Always manage the plan in accordance with all plan documents as long as they are not inconsistent with *ERISA*.

ERISA is unclear, however, about the manner in which to meet these goals. I feel *ERISA* now requires a “process and compliance” driven management style rather than the traditional “value and results” format we are all so familiar with. Further, those standards and best practices

adopted for plan management we develop today should be enumerated in written form to create a clear process through which all fiduciaries may develop a plan of excellence.

So the question becomes one of risk management. How can a plan sponsor and its plan fiduciaries help minimize the personal liability associated with managing a 401(k) plan? I believe one of the only ways to reduce ones personal liability is to “Share the Love.” Plan fiduciaries must establish Investment Committees that clearly define a process of plan administration. For the formation of an effective Investment Committee, I suggest the following.

First, the Investment Committee shall be the investment fiduciary responsible for prudently managing the investment portfolio. It should assume the following responsibilities:

1. Have the exclusive authority to establish, execute, and interpret an investment policy statement for the portfolio.
2. Be solely responsible for the selection and retention of professional advisors to the portfolio, which may include, but not be limited to, investment managers, investment consultants, custodians, attorneys, accountants, and clerical staff.
3. Be solely responsible for the periodic monitoring of plan investments and advisors to the plan.

Second, the Committee should be formally established in writing with its purpose and scope set out in the by-laws. The by-laws should outline the appointment and replacement process of Committee members. The number of Committee members should consist of such number of individuals that are deemed necessary by the plan sponsor. Committee members will acknowledge their acceptance of the appointment to the plan sponsor in writing. Any member of the Committee may resign in writing at any time.

(Note: Directors and officers of publicly traded companies are responsible for ensuring that the persons they have appointed to positions of investment fiduciary responsibility understand their roles, responsibilities, and obligations; and have the ability to carry out their duties with integrity and competence; Sarbanes-Oxley Act, Section 404, FASB Statement No. 132, Secretary of Labor’s amicus brief to Pamela Tittle, et al., versus Enron).

All Committee members should be educated on the fundamentals of *ERISA*. This should include an understanding of a fiduciary’s duties, plan procedures, and service provider’s service contracts.

The plan documents should also be reviewed to understand the plan’s investment strategy and the process for vendor and investment selection. Committee members must understand that ignorance, bad communications, or inexperience is not adequate legal defenses should the plan fall into question.

Committee members can delegate duties to “prudent experts”. *ERISA* requires that plan fiduciary must manage the plan “with 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 like character and like aim”... In the case of *Marshall v. Snyder* a “prudent standard” for exercising fiduciary duties was defined as the “standard of conduct based on a measure of how prudent fiduciaries with experience dealing in a similar capacity and familiar with administration of employee benefit plans would act, rather than how prudent laypersons act.” In short, fiduciaries are held accountable as a “prudent expert.” However, delegating to “prudent experts” does not allow the Committee members to abdicate their oversight function of the “prudent experts.” Remember that the *IRS* and *Department of Labor’s* job is to protect plan participants and their beneficiaries, not the plan fiduciary’s or plan sponsor.

Third, the Committee shall have an office of Chairman and a Secretary. The Chairman shall be responsible for the conduct of all the meetings of the Committee and shall have voting rights the same as any other Committee member. The Chairman shall perform such other duties as the Committee may assign and shall be the designated Agent for service of legal process.

Fourth, the Secretary shall be responsible for keeping minutes of the transactions of the Committee and shall be the official custodian of records of the Committee. The Secretary, together with the Chairman, shall execute all official contracts of the Committee. The Secretary shall compile Committee agendas. The Chairman and Secretary are authorized by the Committee to execute any instruments necessary for the Committee to conduct business.

Fifth, the Committee shall set its own schedule of meetings. Special meetings may be called by the Chairman or by a majority of the Committee members. The Committee shall meet at least once each quarter. Notices of meetings shall not be required if waived by all members of the Committee. In recognition of the importance of the work of the Committee, regular attendance at the Committee meetings is expected from all members. Any member who fails to attend two consecutive meetings of the Committee without an excuse acceptable to the other Committee members shall be deemed to have resigned from the Committee. A majority of the members of the Committee at the time in office shall constitute a quorum for the transaction of business. The action of the Committee shall be determined by the vote or other affirmative expression by the majority of its members in attendance where a quorum is present.

Sixth, an agenda shall be prepared for each regular and special meeting of the Committee. The agenda shall set forth those items upon which the Committee anticipates taking action or discussing. Each agenda item shall have attached backup material necessary for discussion or action by the Committee. A copy of the agenda and backup material shall be furnished to each Committee member prior to commencement of the meeting. Full and complete minutes

detailing records of deliberations and decisions shall be maintained and held by the Secretary. The Secretary shall record all acts and determinations of the Committee, and all such records shall be preserved in the custody of the Secretary. Such record and documents shall be open at all times for inspection by Committee members or for the purpose of making copies by any person designated by the Sponsor.

Finally, in recognition of the importance of accomplishing the objectives of the Committee in a most orderly fashion, the Committee should establish rules of order or adopt Roberts Rules of Order to conduct its meetings. By so doing, a process for plan management will be achieved.

The reduction of liability is a vital concern not only for large corporations, but for mid-sized companies as well. According to Bridgit M. DePietto, a recent speaker at the Midwest Regional Conference sponsored by the Profit Sharing/401k Council of America, “a three-phased approach to filing a suit is being used against large and, most recently, midsize employers” (2006). In August and September of 2006, over a dozen major lawsuits were filed against American companies—a figure that will only increase in upcoming months and years.

While the formalized Investment Committee I have described here will not prevent lawsuits from being filed against plan sponsors and their fiduciaries, it will provide an effective basis from which to build your defense. A major cautionary note; however, the only thing worse than not having an Investment Committee is having an Investment Committee that never meets nor follows its own rules. Companies that sponsor retirement plans can reduce personal liability and achieve a plan of excellence by having standards and best practices. As a major part of best practices, set up an Investment Committee and “Share the Love.”

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