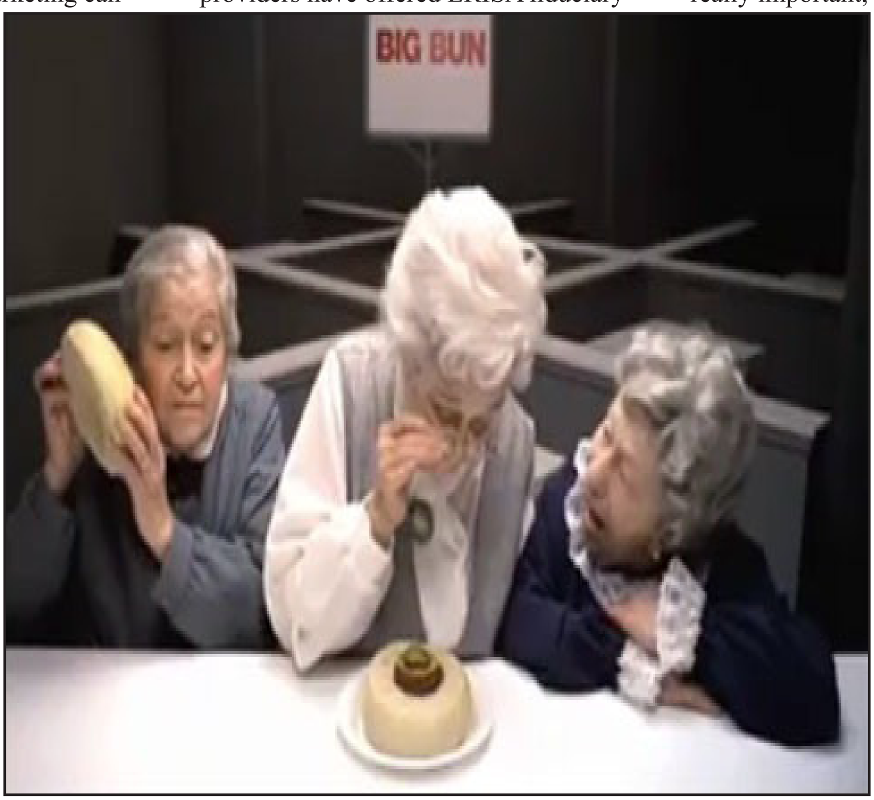
The Worthlessness of The 401(k) Fiduciary Warranty

By Ary Rosenbaum, Esq.

When it comes to selling products and services, marketing is everything. Marketing can help push a product or service into popularity, regardless of whether it's good or not. Spuds MacKenzie was such great marketing; it made people forget how lousy Bud Light really was. Savvy marketing can make something so utterly worthless into something that people want, even if they don't know if they really need it. The marketing by 401(k) plan providers of something called a Fiduciary Warranty is all marketing, it's something more than nothing, but not much more Believe me, Wendy's old pitch woman Clara Peller would have asked these purveyors of 401(k) Fiduciary Warranties "where's the beef?", but these warranties are more like baloney. This article is about the worthlessness of 401(k) Fiduciary Warranties and how plan sponsors should avoid relying them as a form of liability protection.



The most popular F word in the retirement industry these days is fiduciary. Providers of all sorts including yours truly have been expressing to plan sponsors that they have a fiduciary responsibility as the fiduciary of their plan and that they have a fiduciary duty to their plan participants. A fiduciary duty is the highest duty of care in law and equity. Thanks to an upswing in participant lawsuits, as well as more oversight by the Internal Revenue Service (IRS) and the Department of Labor (DOL), plan sponsors are starting to understand the seriousness of being a fiduciary.

Many plan providers have offered products and services to help plan sponsors implement good practices to minimize a plan's fiduciary liability. Some of these providers have offered ERISA fiduciary services to help assume some of the liability that plan sponsors have, basically lightening the load for them. There are third party administrators offering ERISA §3(16) administrator services while there are registered investment advisors offering ERISA §3(21) or §3(38) fiduciary services which can help plan sponsors shed some or most of a plan sponsor's fiduciary liability in managing the fiduciary process. These ERISA services are a welcome addition to this industry because it allows plan sponsors to delegate some or most of their fiduciary responsibility to those with the training to handle it, but it allows other providers to use savvy marketing to exploit the appetite for fiduciary services without offering anything of real value.

A fiduciary warranty sounds nice and really important, but it's something that isn't worth much. It also may make some plan sponsors assume certain protections that aren't there because they use the word fiduciary. A fiduciary warranty is like lightning insurance; actually I think a plan sponsor has a better change of getting hit by lightning than a plan sponsor being defended through one of these warranties.

The word warranty in business carries great importance because it entices a consumer to buy a product or services because it suggests that the company offering the product or service is standing by it. Of course, as with any warranty, there are terms and conditions that limit that warranty that people who don't read the fine print find out in most unfortunate circumstances that they won't be covered. Ask all the neighbors on my block who found out that the contents of their first floor weren't covered under the National Flood Insurance Program because some of that first floor is below grade.

When they hear the words "fiduciary warranty", I assume most plan sponsors think that these plan providers will either serve in some sort of a fiduciary capacity or indemnify the plan sponsor in any lawsuits brought by plan participants for any claim for a breach of fiduciary duty. Of course, these providers go out of their way to make sure that they are not identified as serving in any fiduciary capacity and the fine print in these warranties indicate that the providers will only defend plan sponsors in only in rare instances.

I have reviewed warranties from several providers and they are usually cut from the same cloth. While the language on a warranty is pretty clear, I have been an ERISA attorney for more than 14 years and I know the tricks of the trade. A plan sponsor who in most of these situations isn't working with an ERISA attorney assumes that the plan provider will indemnify the plan fiduciaries in any alleged ERISA §404(c) breach in a participant directed retirement plan. The warranty only states that the investment options that this provider selected were prudent, satisfied the Section 404(c) requirement of offering a "broad range of investment alternatives", and that the investment strategies provide a suitable basis for plan participants to construct well diversified portfolios. So the warranty will indemnify a plan sponsor if they are sued for not having a broad range of investments in their fund lineup. Sounds like a great warranty? Actually, I don't think that the warranty is worth the paper that it's written on.

That whole broad range requirement is rather broad; I am unaware of any plan fiduciaries ever being sued on that requirement. To comply with the simple broad range requirement, the plan fiduciaries must first decide on the asset classes (e.g., stocks and bonds) and styles (e.g., large cap U.S. equity growth fund, small cap U.S. equity value) for the "core" investments of the plan. So plan sponsors need to offer a diverse group of investments.

While this bundled provider state that the investments offered are consistent with the fiduciary standard, the plan's investment fiduciaries still must monitor the investment options to insure that each continues to meet the criteria for the asset class and style and is performing well enough to continue to be offered to the participants.

Warrantying that the investments offered in the plan are part of a broad range of investments and are prudent, these are only a couple of ways where a plan fiduciary can be sued for an ERISA Section §404(c) breach. A plan sponsor and fiduciary can still be sued for not formulating an investment policy statement or offering investment education to plan participants. There are thousands of mutual funds out there; it's not so hard to find five funds that make that broad range requirement or a claim that the investments are prudent. It's especially east to meet the broad range of requirements if the plan sponsor is working with an investment advisor because they certainly should have the background to select the funds to meet this easy requirement.

A fiduciary warranty is almost absolutely no protection for plan fiduciaries, it's like buying car insurance that only covers you in a head on collision or a life insurance policy that only pays on accidental death. It's a warranty that warranties very little. The fiduciary warranty is no substitute for an ERISA §3(16) plan administrator or an ERISA §3(21) or ERISA §3(38) fiduciary or a co-fiduciary. Unless a bundled provider assumes some sort of fiduciary capacity, the plan sponsor as a plan fiduciary is not being protected. It also creates doubt in a plan sponsor on whether they need to purchase fiduciary liability insurance if they assume that the company producing a fiduciary warranty is actually a fiduciary.

The fiduciary warranty is a deceptive practice. Sure, the plan providers will claim that the limits on their warranty are fully disclosed and they are correct. However, most plan sponsors who do not use the services of an independent ERISA attorney will not understand that the protection of liability for the broad range of investments requirements under ERISA §404(c) is such a small part of fiduciary liability and very few cases against plan fiduciaries are ever litigated on that requirement because it is such an easy task. So much of the retirement plan industry is predicated on the assumption that plan sponsors will not closely monitor what they sign in their agreements with plan sponsors. Some small print on the back of a 401(k) fiduciary warranty can not deflate the assumptions that it creates when they combine the words "fiduciary" and "warranty" and these plan providers know that.

Don't be had by a pale imitation, only go for real fiduciaries and real fiduciary protection. Make sure you review your plan provider contracts and warranties for the fine print. Someone who is not willing to be a fiduciary isn't worth the same as the one who will.

THE ROSENBAUM LAW FIRM P.C.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw