What people should know about ERISA plans

By TIMOTHY J. O'CONNOR

With the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), private enterprises were afforded generous retirement savings options that permitted the funding of retirement plans with pre-tax dollars for the benefit of employees.

At the end of fiscal year 1992, Internal Revenue Service figures show that there are more than 1.1 million ERISA-qualified retirement plans in the United States. If you are a trustee, fiduciary or beneficiary of a defined benefit plan or a defined contribution plan, your rights and responsibilities are spelled out in the ERISA statute.

By the early 1980s, the benefits of ERISA-sanctioned retirement savings plans had become widely known, and owners of small businesses were pitched numerous ERISA plan proposals by their accountants, lawyers, professional associations and stockbrokers.

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The signing of the last page of an ERISA plan makes the business owner a trustee and fiduciary for ERISA purposes. Unfortunately, most owners of businesses are not given a crash course on their duties and responsibilities under the ERISA statute, but these are very real responsibilities.

The ERISA statute expressly requires a "prudent-man standard of care," which is defined to include that: "A fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and 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 a like character and with like aims."

This means: Don't purchase tax shelters in your ERISA plan—ERISA plans are already tax-sheltered investment vehicles. Don't load up the asset base of an ERISA plan with direct-participation programs such as limited partnerships, private placement and private offerings. Phrenetic trading in equity, currency and index options is prohibited. Frequent in-and-out trading of stocks and mutual funds is not prudent and does not serve the interests of plan beneficiaries.

ERISA requires a plan fiduciary to "diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances, it is clearly prudent not to do so." The word "prudent" is spelled out in the law. Don't put all your eggs in one basket.

ERISA expressly states that a fiduciary shall not engage in any transaction involving an ERISA plan on behalf of a party whose interests are adverse to the interests of the plan or its beneficiaries. The courts have found liability against financial advisers for heavily investing ERISA plan assets in securities for which the financial adviser's firm served as an underwriter, market-maker and/or principal.

In the 1980s, several large brokerage firms aggressively marketed limited partnerships to ERISA-qualified pension plan accounts, notwithstanding the fact that these very firms served as managing partners, general partners, corporate affiliates and/or marketing agents. From the firm's prospective, this is a clear example of a conflict of interest and self-dealing.

In most instances, the benefits of ERISA plans are made known to owners of businesses by their accountants or lawyers. Being a certified public accountant or a licensed lawyer, however, does not qualify one to provide detailed investment advice about regulated securities. Your accountant or lawyer may have an acquaintance or a golfing buddy who is a financial adviser to whom you may have been steered. This kind of network referral is the most common. Will the accountant who prepares your annual ERISA filings with the IRS give you objective advice on a year-to-year basis while your plan is sustaining devastating losses at the hands of a golfing buddy?

A working knowledge of the ERISA statute is required before any financial adviser can manage completely your ERISA plan. Unlike individual trading accounts, ERISA accounts are not for short-term or speculative trading activity. The long-term goal of an ERISA account should be to provide financially secure retirement for plan beneficiaries.

Federal law provides that any person is a fiduciary with respect to an ERISA-qualified retirement plan to the extent that person exercises any discretionary authority or discretionary control in respect to management of the plan or its assets. Federal law further provides that whether or not discretionary authority is exercised pursuant to a written agreemnt or by means of an informal course of dealings with the assets of an ERISA plan, without a written agreement, such discretionary behavior renders that party a fiduciary for purposes of ERISA liability.

Even though an ERISA plan trustee (for example, a doctor, lawyer, accountant, architect or entrepreneur) may have the final say on how assets in an ERISA plan are invested, if the financial adviser is effectively in control of the ERISA plan assets and the investment adviser's actions are merely rubber-stamped by the plan trustee, a very good case can be made that the financial adviser has been rendered a fiduciary under ERISA guidelines.

Unfortunately, as a matter of practice, the role of many ERISA plan trustees over the past decade has been limited to funding the plan with periodic payments. This relationship of an ERISA plan trustee to his

Continued on ERISA, page 22

ERISA plan trustees need to get proper advice

Continued from page 16

financial adviser can be likened to that of a boiler room laborer in the hold of a steamship stoking the ship's fire with coal (money), while the captain of the ship (financial adviser) is up on the deck at the ship's wheel, guiding the ship's course (the ERISA plan's investment strategy)—a collision course strategy if there ever was one.

ERISA plan trustees should arrange for semi-annual, if not quarterly, meetings with their financial advisers and play a greater role in the active management of ERISA plan assets. No trades should be executed without prior consultation and permission.

If you want to retire without living solely on a Social Security check, now is the time to dust off your ERISA plan documents and read every term and provision, line by line. Sit down with your financial adviser and make sure that your plan is being invested with an eye to long-term growth in order to assure a financially secure retirement.

In many situations, the real beneficiary of your ERISA plan assets may not be the plan trustees and its beneficiaries, but rather financial advisers who have repeatedly traded plan assets for the purpose of generating commissions.

Mismanagement of ERISA plan assets can have serious consequences. Financial advisers and their firms have been held responsible for "opportunity cost" damages incurred by ERISA plans and plan beneficiaries as a result of losses occasioned by improper investment activity. This opportunity-cost damage approach has been defined to include the restoration of the trust beneficiaries to the position they would have occupied but for the breach of trust occasioned by improper investment activity.

In certain circumstances, ERISA plan trustees also may be held individually liable to the extent that they have participated actively in improper investment activity. These damages can be staggering, and include a statutory entitlement to attorneys' fees and the costs.

ERISA plan trustees and beneficiaries need honest and objective advice about the management of ERISA plan assets. Over the past decade, one major brokerage firm marketed millions of dollars worth of speculative limited partnerships for which it served, in many instances, as a managing partner, affiliated entity and/or general partner. In many instances, these limited partnerships were valued in ERISA plan monthly account statements generated by the brokerage firm at their original purchase price—well after the underlying limited partnerships had become defunct.

A second opinion, prior to the date of the purchase of such an investment, might have prevented these devastating losses. You can get a second opinion from an experienced independent fee-based adviser, a reputable money manager or a licensed broker with proven training and background in ERISA.

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