YOUR BIGGEST LIABILITY RISK
MAY NOT BE MEDICAL!

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Now that the easy returns in the dot-com and tech stock market are a fading memory, many physicians are wondering what action to take to repair their retirement plan nest eggs. Unfortunately, the losses physicians sustained in their own accounts may only be the tip of the iceberg of their total losses. A ticking financial time bomb is awaiting many who must also answer to the other participants in the retirement plan.

The unique nature of retirement plans under the 1974 Employee Retirement Income Security Act ("ERISA") imposes special legal requirements on the fiduciaries of the plan. Many physicians and clinic business managers are unaware of the legal dangers they face under ERISA. Many do not know that they serve as a ***fiduciary***, what the implications of being a fiduciary.

Who Is A Fiduciary Under ERISA

Under ERISA, the **plan sponsor** (the employer and its board of directors) and the **trustee** are fiduciaries. In addition, other activities can make you a fiduciary. A fiduciary is anyone who:

- Exercises Discretionary Authority Over Plan Assets
- Renders Investment Advice For Fee Based Compensation
- Has Discretionary Authority In Administration Of The Plan

Many clinics have an investment committee comprised of several non-trustee physicians or employees conducting an oversight function with the ability to hire or fire various investments or investment managers. Such a committee would be a fiduciary. The clinic's business manager or chief financial officer may be a fiduciary if they engage in any of the activities listed above. The fiduciary net can be broad.

The Duties Of Fiduciary Status

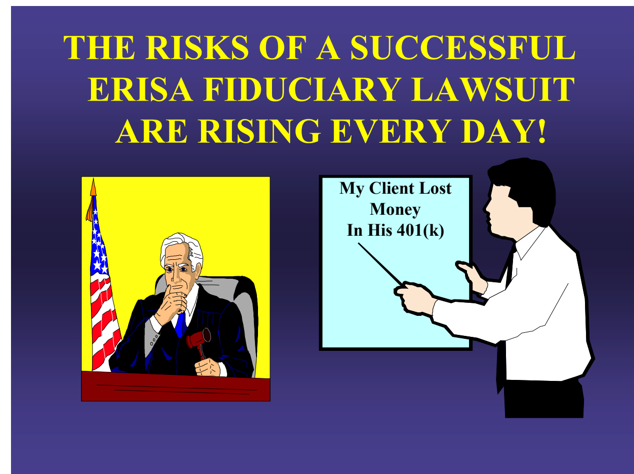
The fiduciary must act solely in the interest of plan participants and beneficiaries. Second, the fiduciary must act for exclusive purpose of providing benefits to participants, and third the fiduciary must use the care, skill, and prudence of a traditional prudent person in the management of plan assets. The fiduciary has a duty to prudently monitor plan investments.

Because the fiduciary must act for the **sole benefit** of plan participants, there can be no "side deals" that benefit the fiduciary. For example, if a bank offers to reduce the corporation's interest rate on a office building loan in exchange for moving the group's retirement plan to the

bank, the fiduciary has violated their duty. If a stockbroker offers to give physicians enhanced IPO access in their personal accounts in exchange for moving the group's retirement plan to the brokerage house, the fiduciary has violated their duty.

The Risks Of Being A Fiduciary

The financial risks of fiduciary status are large, and most groups carry no fiduciary liability insurance. The fiduciary is personally liable for breaches of fiduciary duty. Many such cases are now available for review, and the awards are often in the seven figures. Earlier this year, First Union Bank paid $26 Million to their own employees (including $8 Million to the attorneys) for alleged breaches in mutual fund monitoring and other fiduciary duties.



The fiduciary is:

- Personally Liable For Any Breaches of Duty
- Must Disgorge Any Profits
- Must Make Up Any Plan Losses
- Must Make Up Any Lost Opportunity Costs
- Must Pay Participants' Attorney Fees
- Subject To Stiff DOL Civil Fines

Offering Participants Various Investment Choices Doesn't Automatically Protect

By far, the most popular retirement plans since the late 1980s have been plans offering participant-directed accounts. Such plans are often called ERISA Section 404(c) plans. Part of that popularity is a result of extensive marketing by financial institutions, such as mutual fund companies, stock brokerage firms, insurance companies, and banks that sponsor investment products. Participant directed plans appeal to employers because they (1) increase employee involvement in retirement plans: (2) transfer part or all of the cost of funding the plan to the employees; and (3) transfer investment responsibility to the employees. .

Some financial advisors and stockbrokers have promoted the incorrect notion that as long as the employees have three or more investment choices, there is no need to worry about fiduciary liability. This is not true—just look at the First Union Bank case which offered more than 15 choices!! Unfortunately, most physicians and clinics, along with their officers and directors do not understand that certain aspects of fiduciary responsibility -- and potential liability -- cannot be transferred. Many companies inadvertently fail to take the steps necessary to develop a Investment Policy Statement in order to implement prudent criteria to make the initial selection of the investment options. Finally, the responsible fiduciary must monitor the options to ensure

that they continue to be a prudent choice for the plan. Lack of prudent management, lack of ongoing monitoring, and lack of documentation of these activities leaves plan fiduciaries exposed to personal liability for employee investment losses.

Who Should Serve As Trustee?

There are three basic types of trustee arrangements. Plans can be ***self-trusteed*** where the doctor or other individual serves as trustee. In such cases the person serving as trustee faces the full fiduciary liability. The plan sponsor can hire a corporate trustee as either a ***directed trustee*** or ***discretionary trustee***. A directed trustee provides little if any fiduciary oversight, and serves mostly as a custodian. The discretionary trustee provides a fiduciary oversight and some risk management. Keep in mind that the plan sponsor (and perhaps certain individuals at the company) would still be fiduciaries to the plan, even with a discretionary trustee.

Identifying and Monitoring Prudent Investments

Each plan should have a written Investment Policy Statement to outline prudent criteria. Recent reports have estimated that at least 50% of all retirement plans have no written investment policy. Just writing a policy and stuffing it in a file somewhere is not enough. The key to the process is to create a living document with ongoing monitoring.

What is prudent? The legal requirement for prudence under ERISA is for a fiduciary to discharge its duties with, among other things, "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 is sometimes referred to as the "prudent expert rule", because ERISA requires that the fiduciary act not just with prudence, but with the prudence that someone "familiar with such matters" would exercise.

As a practical matter, prudent in this context means selecting investment options that are expected to perform reasonably well relative to other similar investment products and against appropriate standard indexes. For example, if the investment options are mutual funds, prudence does not mean that the responsible fiduciary must pick the outstanding fund in every investment category or must constantly switch funds looking for the best performer. It does mean periodically (e.g., quarterly or not less than annually) reviewing how each fund has performed historically relative to other funds and benchmarks, and making changes when appropriate. Since the fiduciary will be held to the "prudent expert" standard, other relevant factors (internal expenses, etc) based upon academic research must also be considered in the overall monitoring process.

In fulfilling the duty to monitor the investments, the responsible fiduciary -- the board of directors, a plan investment committee appointed by the board, or one or more company officers -- should review the performance of each fund quarterly, or at least annually, against a comparable index of performance. The fiduciary should look to see if each fund compares

favorably to the performance of other funds of the same type and with the same investment objectives. The responsible fiduciary should determine whether the funds have a poor rate of return relative to other similar funds and in relation to the appropriate benchmark or index. If so, the fiduciary should consider switching funds, and at some point, a prudent fiduciary will be obligated to switch funds. Since this entire process is very labor intensive, the group may elect to hire experts to help with this process.

Documenting the Process

Physicians understand the importance of daily progress notes in the patient's chart. The exact same principle applies to fiduciary monitoring. Conducting investment choice comparisons is not sufficient, however without documentation. The fiduciaries need to keep minutes of the meetings at which they conduct their review. The minutes should reflect the results of comparison research, alternatives considered and why they were chosen or rejected. Such documentation should be included in corporate minutes and board of director minutes. Also, copies of the materials reviewed at the meeting should be attached to the minutes. If these steps are taken – hiring a discretionary trustee, development of a written Investment Policy Statement, prudent selection of the investment options, compliance with the requirements of ERISA Section 404(c), and proper documentation of ongoing monitoring of the investments -- the fiduciaries should avoid liability for any losses suffered by the plan participants on the investment options that the participants select.