THE EXCELLENT FIDUCIARY

Employee Benefit Risk Management from a Board's Perspective

*Ronald E. Hagan**

Risk-taking is an integral part of business activities. The risk appetite defines how much risk an organization will take on overall. Boards of directors are faced with the challenge of deciding which risks it makes sense to embrace; these will primarily be those risks the organization owns, and by that we mean those risks which it is equipped to manage and exploit. This article discusses tactics boards use to gain a thorough understanding of their organizations' risks, how fiduciary risk ranks among other hazards, the effect risk culture has on how directors prioritize risks and includes suggestions on how to strengthen the management of risks associated with employee benefit plans.

THE SCOPE OF BOARD RISK

"Risk" is a very simple word but it embraces a complex web of potential liabilities that are often stimulated by the very nature of an organization's core business. Risk resides in multiple locations within an organization and has the potential to initiate complex consequences. The responsibility for constructing an enterprise risk management system begins with an organization's directors. Boards that demonstrate strong leadership gain an understanding of the scope of the threats they face and can counter business and regulatory threats with these steps:

1. **Learn**—At a high level obtain a thorough understanding of the regulatory and business mix that affects the enterprise;
2. **Prioritize**—Adjust risk management policy to match the board's risk appetite;
3. **Assess**—Evaluate where gaps between current board policies and risk management processes might exist employing third-party experts where in-house assessment experience in a risk category is lacking;
4. **Install**—Risk management systems do not come in one size fits all containers. For example,

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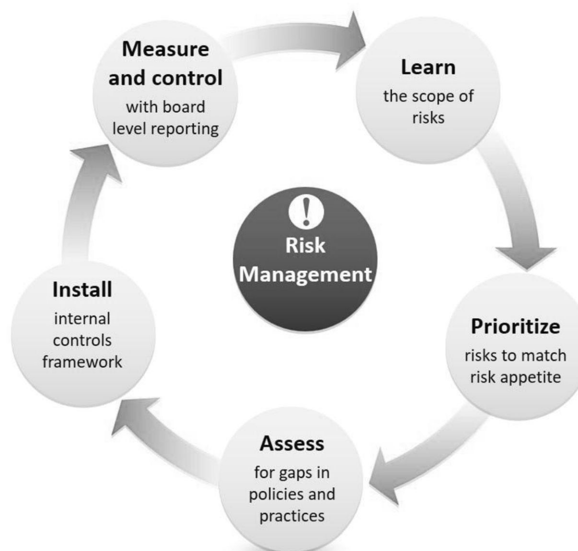
a framework of internal controls for fiduciary risk management is unlike the controls needed to comply with other threats that enterprises face; and

5. **Measure and Control**—Monitor the risk system for early warning of threats developing using automation where possible to ensure that standards and persistence are maintained.



Measuring risk management success based on the lack of regulatory or litigation problems alone offers no guarantee that adverse action won't emerge. A carefully monitored risk management framework is the only way to achieve and maintain calm assurance at the board level. That's proving to be especially true with respect to employee benefit plans.

ELEMENTS OF A RISK CULTURE

Many observers agree that the 2008–2009 financial crisis was caused in great measure by risk culture failures. The lessons learned in the aftermath of that difficult period reveal that a board of directors' philosophy about risk can have a profound impact on the destiny of an enterprise.

The culture of enterprises in the new risk management era has definable elements:

1. A distinct and consistent **tone from the top** of the organization defines the boundaries of risk taking decisions.
2. The organization's **commitment** to ethical principles, practices, and policies is clearly defined and communicated by the directors to executive leaders.
3. The degree to which managing risk is an **accountability** across the organization is integral in the enterprise's policies and procedures.
4. Risk **reporting is transparent** and encouraged.
5. The impact of adverse events and "near

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misses" are used to **create teachable moments** for the management team.

6. **Risk taking** is rewarded within the boundaries of the organization's risk appetite.
7. Risk management **skills** are valued, encouraged, and developed.
8. Risk management is properly **resourced**.
9. The directors **evaluate** periodically the definition of risk.
10. The **risk culture** is periodically challenged from diverse perspectives.

PRIORITIZING EMPLOYEE BENEFIT PLAN RISK

The Employee Benefits Security Administration's ("EBSA"), which is the enforcement arm of the U.S. Department of Labor, reported recently that it had a higher level of total monetary recoveries in FY 2017 than the previous year. It handled 174,000 inquiries and restored over $418 million in benefits through informal resolution of individual complaints, and that doesn't include another $600 million that it collected because of enforcement actions it initiated.

In addition to regulatory activity, lawsuits that allege the violation of fiduciary duty by organizations that sponsor 401(k) retirement plans continue to grow in number. In recent months similar lawsuits have been filed that target 403(b) plans sponsored by several major universities.

By any measure enterprise risk related to ERISA qualified benefit plans is worthy of the high priority that's typically assigned to such regulatory programs as those administered by OSHA and the EPA. Evidence exists, however, that directors are not yet adjusting to a paradigm shift in the degree to which employee benefit plans expose an organization to liability. For example, despite persistent growth in the number of well publicized adverse regulatory and legal actions against organizations for breach of their fiduciary duty, recent lawsuits reveal that the targeted organizations have not yet learned fully the lessons taught by the experiences of others. Many boards rely on past experiences in setting their risk priorities "the way things have always been done" or by a collective consensus to arrive at an acceptable ranking. But the pattern of risk management that adjusts to the changing environment rewards directors and senior leaders who match risk appetite with internal controls that measure not only *what* is being done but also *how* it is accomplished.

CLUES THAT IT'S TIME TO RETHINK RISK PRIORITIES

Organizations that sponsor ERISA qualified employee benefit plans should be freshly evaluating the scope of their exposure to the threats posed by their fiduciary status. An assessment of the governance structure, guidelines used for monitoring operations, and training program for key personnel are integral parts of a risk evaluation.

Our firm's assessments continue to identify several common characteristics of organizations whose risk priorities need to be adjusted. We have found that the potential for regulatory action and liability claims are higher in organizations whose governance systems possess the following traits:

- boards of directors tend to rank employee benefit related programs at or near the bottom of the list of their risk management considerations;
- the organization lacks a system of internal controls specifically constructed to guide, report, and remediate its regulatory and legal exposure;
- retirement plan benefit

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committee members lack formal training in ERISA's fiduciary standards of care;

- human resources personnel turnover at a higher than industry normal rate;
- the organization sponsors multiple retirement plans;
- the in-house fiduciaries rely heavily on a primary vendor who they think relieves them and their organization of their fiduciary risk;
- compliance systems fail to use computer automation and are based on manual systems that allow for errors of both commission and omission;
- vendors are not evaluated against alternatives on a periodic basis;
- retirement plans pay excessive compensation to vendors; and
- assessments of governance policies and procedures against best practices are infrequent or never performed.

STRENGTHENING RISK MANAGEMENT

In simpler days, employee benefit committees convened to hear presentations from the vendors that were employed to provide investment and administration services. In those days, intuition, or plain old common sense, was often sufficient for making the right choices. Throughout the last decade, though, major events transformed the collaborative approach for committee decision making into a wieldy and danger-ladened strategy. Many ERISA plan sponsors now bear troubling consequences for not altering their committee structures in reaction to the passing of that old era. In growing numbers, they are embroiled in expensive lawsuits for breaches of fiduciary duty and regulatory sanctions that could have been avoided.

In those days, there was no pressure for a committee necessarily to have objective subject matter expertise or a diversity of perspectives. Where the old era devalued these principles, the new era embraces them as an essential consideration to achieving regulatory assurance. This idea appears to be common sense, as a diverse group would have a more balanced, holistic perspective on issues—but it was not a common practice (and in some cases, still is not) in fiduciary risk management committees of leading U.S. corporations and higher education institutions until recently.

We see many organizations that are now committed to implementing risk management systems that test the objectivity of their management practices and vendor relationships. (Most important to this trend is ensuring the policies are regularly evaluated, updated and actively in effect.) Reward metrics change in the new era, as well. Personnel must be rewarded and incentivized for advancing the risk culture, in addition to sheer performance.

This philosophical shift in focus on compliance practices characterizes the transition from the old fiduciary era to the new era, and illustrates the higher burden faced by ERISA plan sponsors and boards of directors going forward.

A new environment has crept up on many organizations that necessitates an unprecedented strengthening of their risk management approach.

A NEED FOR SPECIALIZATION

Nearly without exception, ERISA plan sponsors outsource investment advice, money management, recordkeeping, and third-party administration services. In essence, a committee's fiduciary role is constrained to managing a ***process*** rather than managing ***outcomes***. Vendors, not committees, actually make invest-

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ment decisions, deliver employee communication programs, provide web-enabled information platforms for ERISA plan participants, calculate benefits, and prepare government filings.

The sophistication of the vendors on whom committees rely, however, has outpaced the ability of plan sponsors to properly select and monitor them. Very few executives that populate committees possess technical skills that can match the skills of the experts to whom they delegate needed services.

The industrial sector of the U.S. economy faced the reality decades ago that independent assessments of governance, risk management, and compliance ("GRC") is essential. The time has come for the ERISA plan sponsor community to accept a similar reality. Federal regulators, and even the courts, have come to recognize that the lack of formal GRC systems is a critical weakness in the employee benefits arena. The solution begins with establishing servicing sector specialization at the committee level. Servicing sectors include investment advice, investment management, and administration.

Committees need to embrace specialization. Selected members should be assigned to the role of Sector Specialist, at least one for each servicing sector. These specialists should be equipped with special training (and, specifically, not by any provider of ERISA plan services). If necessary, independent experts in **employee benefit plan centric GRC** should be engaged in order to help the specialists acquire the skills and resources needed to retake ground that has been abdicated to ERISA plans' vendors. A thorough independent review of the committee's ***decision-making workflow*** and ***internal controls*** can be the first step taken to this end. (Learn more about a GRC management system evaluation at www.RolandCriss.com/Assurance.)

RESTRUCTURE AND REVITALIZE

To meet the requirements of the new fiduciary risk era, an evaluation of the employee benefit committee is essential. A realignment of the committee, its responsibilities, and its management practices can be the difference between avoiding liability and disappointing plan participant losses or damaging regulatory enforcement actions. The benefits of restructuring the committee are far-reaching, and include:

- **Service Sector Specialization**—Specialization eliminates the "knowledge gap" that vendors have fostered, enables cost reductions for vital employee benefit plan services, and instills a professional governance system;

- **Improved Outcomes**—Retirement plan investments, including corporate contributions to defined benefit and welfare plans like VEBAs, perform better due to the elimination of excessive fees for services;

- **Peace of Mind and Streamlined Workflow**—Committee members' fears of overlooking required fiduciary functions are eliminated;

- **More Effective Committee Meetings**—A redefinition of what's important eliminates time wasted on superfluous issues and maximizes impactful results;

- **Risk Management**—The updated committee structure reduces enterprise risk and builds a firewall around the plan sponsor's legal duty to prudently select and monitor service providers.

The fiduciary risk committee sets the stage for the new era

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of fiduciary duty and, if leveraged correctly, will be the vehicle that allows boards of directors to effectively mitigate liability, gain peace of mind regarding their organization's fiduciary practices, and seamlessly fulfill their ethical role as steward, and leader, in the years ahead.

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