THE EXCELLENT FIDUCIARY

When Fiduciaries Fail

*Ronald E. Hagan**

Reports are plentiful of employers trapped in legal proceedings for violating their trusted role as the overseer of their employees' retirement plans. Until recently, we only heard rumors of suspected lethargy among the overseers. But the frequency and number of failed leadership allegations among them on social media, in the 24-hour broadcast news cycle, and print media tends to taint the reputations of all employers in the public eye. Wisdom calls for a change in fiduciary behavior.

CFOs and HR managers occupy the front line of responsibility for employer-sponsored retirement plans. Typically, they are the primary fiduciaries for those plans. Dramatic changes in the national workplace in 2020 call for skilled leadership in HR matters. The failure to actively and competently lead through those changes can be catastrophic. Litigation in the retirement plan field provides graphic evidence of the need for change in management methods. Failed fiduciary leadership exposes four parties to great harm: (1) employees, (2) employers, (3) C-level executives and HR personnel, and (4) investors. Employees' retirement savings can get wasted, while employers may be fined by regulators and sued by their employees. Primary fiduciaries are at risk of being sued personally, and the equity value of investors' is at risk. A transformation of the practices of primary fiduciaries is needed. This article includes practical guidance on how to meet that need.

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THE RELEVANCE OF THE ENTERPRISE FIDUCIARY

Any enterprise, whether commercial or nonprofit, that still views stewardship as just an altruistic principle, needs only to look at the impact of stewardship negligence caused by some of the world's most influential organizations. Examples include Enron's infamous destruction of billions of dollars of its retirement plan assets in 2001, the "Great Recession" of 2008 triggered by the financial industry's abuse of the mortgage lending market, oil giant British Petroleum's devastating environmental disaster in 2010, and lawsuits against scores of corporations and universities that erupted over the last few years for violating their fiduciary duty, with new suits emerging nearly monthly against large and small employers alike.

In retrospect, the boards of directors of those organizations would undoubtedly agree that proper stewardship—taking care of resources entrusted to the employer—would benefit all of its stakeholders. But the breakdown of stewardship—albeit, likely for a justifiable cause (such as money- or time-saving measures)—results in a ruinous loss, both for the employer and for those who trusted its stewardship competence. Before presuming that any enterprise has a responsibility to more than itself, we need to examine the philosophy and origination of the term "steward."

FIDUCIARY DUTY IS A CROSS-CULTURAL PRINCIPLE

"Stewardship" is originally a Phoenician term, and the root word for "trust." Stewards bear responsibility for the trust invested in them—to oversee, properly manage, and protect certain given objects, principles, or people. "Trust" became the root word for "fiduciary," which today represents something "held or founded in trust or confidence." The link between "stewardship," "trust," and "fiduciary" traces back to the origins of those concepts. By any benchmark, the role of a fiduciary is a noble calling. It is a principle that undergirds the behavior of cultures throughout the world.

In the U.S., governing boards are legal fiduciaries to several people—their employees and investors, to name a few. Stewardship and trustworthiness, then, emerge not just as theoretical guiding principles, but rather, they exist as essential ingredients in enterprise responsibility. The focus on stewardship today does not insinuate enterprise leaders' ignorance of stewardship until now. Leaders have always intended to perform well and create value for their employers and their stakeholders. They have been stewards all along, but the intentional focus on the practice of prudent stewardship—to fertilize defined contribution retirement plan programs, to retain stockholders, to avoid risk and penalty, and to grow as an organization—is mostly a recent phenomenon. The integration of standards into global corporations and retirement plan operations is the line of demarcation between an "old era" and a "new era" of management excellence. In the new era, the promise of intentional stewardship is mandatory for a business' success. And with a new success metric comes a demand for systems that will drive and support this new standard.

WHY FIDUCIARIES FAIL

It is hard to imagine that executives would purposely fail to seek excellence in their role

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as trusted managers (that is, fiduciaries) of their employers' retirement plans. The result of failing in that duty can be grim. Why then do regulators reveal a steady uptick in the number of employers whose operations fail to conform to even primary fiduciary standards of care?

The answer is not difficult to ascertain. Some senior managers think that changing existing methods is not an option. Others know they should upgrade their standards but are unable to develop and install improvements due to a lack of know-how.

THE ILLUSION OF INACTION

Regulators and the legal community expend high energy attempting to focus the attention of employers on the need for continuous improvements in their fiduciary management methods. Despite that, retirement plan committees are prone to ignoring calls to adapt to changes in compliance systems and best practices. It is never an option, however, to ignore rule makers and risk management experts.

The lack of responsiveness by leaders who are comfortable with inaction is an act of self-deception. Assuming that upgrades in oversight methods can follow a pace that is based on what is convenient, rather than on real-world priorities, is a dangerous attitude. As many leaders have discovered, no enterprise has sufficient influence to head-off a clash with federal watchdogs and activist employees when they ignore or violate standards of care. In essence, regulatory conditions are beyond employers' control.

Risk managers (that includes HR executives) who do not instigate needed changes in their management methods, even when they recognize their exposure to fiduciary risk, often lack determination. Symptoms include the avoidance of competing opinions, resistance to new ideas, and dismissal of expert guidance.

WHERE FIDUCIARIES ARE SUSCEPTIBLE

The administration of employer-sponsored retirement plans is the discipline that holds the most significant threat of failure in fiduciary care for thousands of enterprises. The major difference in this discipline now is that there is greater accountability, and thus, more attention focused on how managers fulfill their responsibilities.

In the old era, many enterprise leaders could assume responsibilities were being upheld—by a third-party vendor—without as much duress regarding potential liabilities and risk. In the old era, abdication was epidemic. In that environment, providers were hired regularly and given full corporate stewardship sway without a way to measure whether they handled their duties well. Outsourcing to recordkeeping firms increased in popularity, creating the need for new metrics by which to evaluate their performance. Along with delegating operational tasks to recordkeepers, many employers shifted their compliance expectations to those vendors. Due in part to vendors' aggressive marketing tactics, some HR leaders did not take into account the relief from a legal fiduciary role that recordkeepers enjoy. Unwittingly, they delegated operational tasks but retained the fiduciary risk. The lack of proper vendor oversight is a root cause of the steady stream of legal complaints filed in courtrooms across America against employers and their fiduciary committee members.

As history shows, the development and analysis of performance evaluation metrics did not maintain an appropriate pace with the outsourcing movement. In the new era, laws, regulations, and court decisions require executives to take more responsibility in the evaluation and monitoring of their policies and vendor relationships.

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FIVE DEADLY DUTIES

We are often asked by executives and managers to reveal the specific duties that are the most susceptible to retirement plan fiduciary failures. An abundance of regulatory reporting and litigation results point to five tasks or activity categories that trap employers in a web of potentially dangerous economic and reputational risk. They are discussed briefly below and presented in no particular order of priority.

- **Workflow**
  Broad in its reach, short on implementation specifics, and bristling with teeth, ramped up enforcement of fiduciary standards of care under the Employee Retirement Income Security Act of 1974 (ERISA) has CFOs and HR executives scrambling. Their methods used to demonstrate compliance with ERISA's best practices are mostly haphazard. The need for modernized workflow management programs is exploding.

- **Vendor Management**
  Hiring and managing investment and administration vendors for retirement plans is complicated and risky. Complex due to confusing jargon and interlocking vendors. Dangerous because buyers are at a significant information disadvantage. Inferior services and excessive compensation fuel a prominent number of lawsuits and regulatory fines against employers. Fiduciaries, not vendors, are accountable for the adequate performance of vendors and the reasonableness of their compensation.

- **Investments**
  A common theme found in many of the fiduciary lawsuits currently working their way through the courts centers on the defendants' investment decision-making *process*. Typical complaints allege that the committees that manage the process failed to ensure that each investment option was prudent. Also claimed frequently is that the fiduciaries maintained mutual funds in the plans despite the availability of the same or similar investment options that possessed histories of lower costs and better performance. The key for executives is to realize that being able to demonstrate a consistently applied decision-making process is vital. Abdication of that activity to a recordkeeper or any third party is indeed foolhardy.

- **Data Security**
  Generally, retirement plans qualified under ERISA lack a data security policy. Such a policy defines the standards, which require an employer to implement essential safeguards to protect the confidentiality, integrity, and availability of the Personally Identifiable Information (PII) of a plan's participants. Privacy depends upon security measures: no security, no privacy. The U.S. Department of Labor (DOL) reports that attacks on PII occur frequently. As a result, the DOL requires employee benefit plan sponsors to recognize PII and to handle it securely. ERISA makes it a fundamental fiduciary responsibility. (Roland|Criss offers a data security policy prototype.)

- **Payroll Reconciliation**
  Like the hollow wooden Trojan horse in Greek mythology that concealed an invading force, payroll can secretly undermine the compliance efforts of every organization that sponsors a defined con-

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tribution retirement plan. The point at which a retirement plan and a payroll system intersect is a breeding ground for the most common violations of fiduciary duty. And they can be the most unwieldy to fix.

WHERE TO GO FROM HERE

When correctly performed, three steps outline a repeatable way to achieve and maintain excellence in the fiduciary role. They include:

- *Assessment:* A systematic evaluation performed by a specialist that can uncover gaps in the oversight systems on which primary fiduciaries rely.
- *Action plan:* A tool that helps leaders model how to upgrade their enterprises' oversight and risk management methods.
- *Adjustment:* A series of steps that implements improvements and monitors the performance of the management system and third parties ongoing.

CONCLUSION

Achieving the attributes of an excellent fiduciary is made considerably easier by maintaining a high level of skill in relevant task disciplines and a state of the art workflow built around best practices and performance monitoring. Being mindful of the high calling of a trusted steward should elevate the awareness of leaders from a singular job description perspective to a holistic, process-centric vision, which, over time, produces the most rewarding results—through ethical, responsible, and intentional practices. Failure is not an option.

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