

# Fiduciary Glossary

Fiduciary or Pension Trust Liability Glossary

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**CAP penalties:** Penalties that may be assessed under the IRS's voluntary Closing Agreement Program, one of several compliance initiatives at the Service.

**Cash balance plans:** Plans that typically started as defined benefit plans and were then "converted" into cash balance plans (otherwise they may simply be created as such). The benefits include limiting the plan sponsor's ultimate pension obligation, providing portable account balances that can be carried from job to job and earlier vesting of benefits. Potential drawbacks may include confusion as to the impact of a conversion on a given employee as well as the possibility that more senior employees may not accumulate additional benefits for a period of time, perhaps several years, depending of the terms of the plan.

**Co-fiduciary liability:** Refers to the fact that fiduciaries under ERISA are jointly and severally liable for the actions of their fellow fiduciaries if they: 1) could have and should have been aware of a violation, and 2) could have and should have done something to prevent or ameliorate the damages from a breach.

**Collectively bargained plans:** Found where there is organized labor; they provide retirement benefits under a collective bargaining agreement. Sometimes these plans are also referred to as Taft-Harley Plans in deference to the law that sets out many of the rules relating to collective bargaining. If more than one employer contributes to the plan, it is treated as a multi-employer plan and is subject to special rules (in addition to ERISA). If only one employer (including affiliates) contributes to the plan, it is merely subject to all the same rules as other plans that do not cover union employees.

**Controlled group of corporations:** Any of three types of corporate structures: (1) the parent-subsidiary controlled group, (2) the brother-sister, or sibling controlled group, (3) and the combined group. The existence of the controlled group is very important because it creates joint and several liability, amongst the members, for contributions owed to the qualified (ERISA) plans of any of the members. Then, too, all employees of corporations that are members of the controlled group are treated as employed by a single employer for plan qualification purposes. A general rule is that 80 percent ownership is required to establish a controlled group relationship.

**Defined benefit plans:** Pension plans that provide a preset amount of retirement income to the participant based on various factors such as salary, length of service and age at retirement. (Also see defined contribution plans, plans, and pension plans.)

**Defined contribution plans:** Pension plans that provide individual accounts for each plan participant based upon the amount contributed to the account (for example, two percent of salary) plus or minus any income, expenses, gains and losses allocated to the account.

**Discrimination:** The result of a plan that through its provisions or operations favors officers, shareholders or highly compensated employees over other employees. It may also refer to circumstances under which companies or plans retaliate against, or otherwise treat unfavorably, plan participants as a result of or consequence of their entitlement to certain ERISA benefits. This is illegal under ERISA.

**Disqualification:** The loss of qualified (tax-favored) status by a plan. Usually this is as a result of operating the plan in a manner that is contrary to its provisions or that discriminates against the rank-and-file employees.

**Distress termination:** The termination of a single-employer defined benefit plan, covered by the PBGC, because it is currently unable or will become increasingly unable to pay all of its benefit obligations.

**DOL:** The Department of Labor, which enforces ERISA's standards of fiduciary duties, responsibilities and obligations as respects all types of ERISA plans. Methods include plan audits, complaint investigations, negotiated settlements, civil and criminal litigation, and assessing civil penalties. The DOL is one of the three government enforcement agencies for ERISA plans. (Also see the IRS and PBGC.)

**ERISA:** The Employee Retirement Income Security Act of 1974 and all subsequent amendments. It sets out the duties, responsibilities and obligations of those who are deemed to be fiduciaries under ERISA. It also created the PBGC. (See PBGC).

**ERISA bonds:** see fidelity bonds (Not to be confused with Fiduciary Liability insurance!)

**ESOP:** An employee stock ownership plan, which is any defined contribution plan that according to its terms must invest its funds primarily into employer company stock. Unlike any other type of plan, ESOPs may borrow from the employer or use the employer's credit to acquire company stock (these are referred to as leveraged ESOPs). Note that defined benefit plans may hold up to 10 percent of their assets in company stock, but are not ESOPs. See also KSOP.

**Exclusive benefit rule:** A rule holding that ERISA fiduciaries must discharge their duties solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing them their benefits while paying reasonable administrative expenses. This may sometimes create conflicts for company directors and officers while acting as ERISA fiduciaries.

**Fidelity bonds:** Mandated under §412 of ERISA for all individuals that handle plan funds. ERISA sets minimum thresholds for the bonds that are designed to cover the potential theft of plan assets (the lesser of 10 percent of plan assets or \$500,000). The Act also provides that the DOL will approve the form of the bond (with a zero retention) and approve certain carriers for its issuance.

**5500s:** The annual IRS financial report, including a balance sheet and income statement, required of each plan. Because of the timing involved, they are often at least a year or more out of date. Many Fiduciary Liability underwriters use them as part of their underwriting review.

**502(i) penalties:** The five percent per annum penalty that the IRS can assess for prohibited transactions under ERISA involving a party-in-interest (so not just fiduciaries).

**502(l) penalties:** The 20 percent penalty that the DOL assesses for violations of ERISA's fiduciary responsibility section. If the violation has already resulted in the assessment of a 502(i) penalty, then the DOL will deduct this from what is due the Department under 502(l).

**401(k) plans:** Defined contribution plans in which employees can choose to defer portions of their income and make pretax contributions. Typically there is an employer "match" for the employees' contribution so that for every dollar or percentage of salary that the employee contributes, the employer also pays into the employee's account. The hallmark of a 401(k) plan is the employees' control over how the plan monies are invested. Usually there are a number of plan options or investment opportunities through which the participant gets to diversify his or her investments. Also see spillover or mirror 401(k) plans.

**Fiduciary:** Under ERISA, refers to a person who has or exercises discretionary authority or discretionary control over plan management, the disposition of plan assets, or plan administration. It includes any person who provides investment advice to the plan for a fee or other compensation. "Fiduciary" is a functional designation; one may be a fiduciary because one acts, or

had the duty or responsibility to act as a fiduciary for an ERISA plan. Example: those who delegate fiduciary responsibility are exercising fiduciary authority and so are fiduciaries as respects the delegation decision. (See co-fiduciary.)

**Frozen plan:** A pension plan that continues to exist even though the employer no longer makes contributions and vesting does not continue to occur. This is typically done to give plan assets the chance (through compounding returns) to catch up to plan liabilities. In the meantime, plan participants may be offered a new “ongoing” plan (usually a defined contribution plan).

**Insured plan:** A plan funded exclusively by insurance contracts.

**IRS:** The US Internal Revenue Service. Due to ERISA's beneficial tax treatment of ERISA plans, the IRS is empowered to audit for ERISA compliance. Where it finds violations it may negotiate settlements, litigate and assess penalties. The IRS is one of the three government enforcement agencies for ERISA plans. (Also see the DOL and PBGC.)

**KSOP:** 401(k) defined contribution plans that are designed to hold company stock.

**Named fiduciary:** A fiduciary named in a plan. A special feature of the named fiduciary is that he, she or it has the authority to designate others to carry out fiduciary responsibilities (including investment of plan assets). This right to delegate ERISA fiduciary responsibility carries with it ERISA liability if the delegation is not prudently handled. For this reason, one may say “the buck stops here” when other fiduciaries to whom authority has been delegated, breach their fiduciary responsibilities. Often, either the plan sponsor (the employer) or the plan administrator acts as the named fiduciary.

**Nonqualified plan:** An employee benefit plan that does not have the tax-favored status of an ERISA plan, usually because it is designed for a highly select group or individuals who are highly compensated, rather than a broad cross-section of employees. By their very nature, these plans are typically discriminatory, but this is not a problem as they are not subject to ERISA's nondiscrimination rules. While they do not fall with Title I of ERISA's fiduciary responsibility section, they are subject to the state common and statutory law of trusts. See discrimination.

**Partial termination:** Typically occurs when the employer terminates large number of employees, substantially reducing the percentage of employees participating in the plan. The unintended effect is the vesting of benefits. The unanticipated, sudden vesting, increases plan liabilities at the same time that payment of these benefits may become imminent (as those qualified for benefits, but previously unvested are now out of work and applying for benefits).

**Party in interest:** An individual or entity that because of its relationship with the plan (as fiduciary, service provider or sponsor) is prohibited from entering into certain transactions with the plan. See prohibited transactions.

**PBGC:** The Pension Benefit Guarantee Corporation created under ERISA to insure the vested defined benefit pension plan benefits (similar to the FDIC for banks). The PBGC is one of the three government enforcement agencies for ERISA plans. (Also see the DOL and IRS.)

**Pension plan:** Any plan, fund or program that: 1) provides retirement income to employees, or 2) involves the deferral of income for employees for periods extending to the end of employment or beyond. Pension plans may be either defined benefit or defined contribution plans. Individuals may become vested in pension plans, at which point the right to either immediate or future benefits becomes non-forfeitable.

**Plan:** Under ERISA, either a pension plan or an employee welfare benefit plan.

**Prohibited transactions:** Specific transactions that may not be entered into, either directly or indirectly, by a party in interest and the plan. This includes but is not limited to the sale, lease, loan or exchange of goods or services. Certain

specific transactions may be granted an exemption from these rules by the DOL; those not so lucky are subject to civil fines and penalties; see 502(i) and 502(l).

**Prudent-expert rule:** ERISA's standard under which a fiduciary must act. It requires all "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 standard is stricter than the prudent-person standard applied to corporate directors and officers (among others).

**Qualified plan:** An ERISA plan. See disqualification and nonqualified plan.

**Sold plan or spun-off plan:** Used to describe the situation in which an employer divests itself of an operating unit and its employees, and with the corporate asset sale also transfers the employee benefit plan(s) and accompanying assets to the new employer.

**Spillover or mirror 401(k) plans:** Nonqualified plans, typically unfunded, which provide for benefits in excess of the IRS limitations on possible 401(k) plan benefits. Unlike most nonqualified plans, these may be available to a large cross section of employees.

**Taft-Harley plans:** See collectively bargained plans.

**VEBA:** A voluntary employee benefit association. The employer generally administers but technically does not sponsor the plan on behalf of its employees. This means that the company arranges for the purchase of the benefits and facilitates the communication of this offer to the employee and the payment by means of payroll deductions. But the employer generally does not pay for any of the benefits provided (generally dental and eye care, but necessarily limited to these). Usually, but not always, these plans are nonqualified.

**Vested benefits:** Benefits that have become non-forfeitable. At vesting, the participant or beneficiaries will be entitled to their benefits as they become due without any further ado. Usually, pension benefits vest after some period of service or participation in the plan (or both), while welfare benefits don't ever vest. This means that when the employee leaves the job and/or the plan terminates, or any time between, the participant or beneficiary's right to benefits under the welfare benefit plan may cease.

**Waiver of recourse:** A Fiduciary policy extension that is most common for multi-employer plans or whenever the policy premiums are paid with plan assets. When the premiums are paid from fund assets, rather than by the plan sponsor or individually by a fiduciary, ERISA §410(b)(1) requires the insurer to retain a right of recourse against the fiduciaries for any breach of fiduciary duty that they commit. Under a waiver of recourse endorsement, the individual fiduciary pays a portion of the policy premium and the carrier waives its right of recourse. If an individual fiduciary purchases the coverage from and for his own account, then ERISA does not require the carrier to retain a right of recourse.

**Welfare benefit plans:** Any plan, fund or program to provide the employee or beneficiaries with benefits for: medical care or treatment, sickness, accident, disability, death, unemployment, vacation, apprenticeships (or other training programs), day care for children, scholarships, prepaid legal services and others. Welfare benefit plans, as opposed to pension plans are usually funded on a pay-as-you-go basis. Unless specifically provided for otherwise, welfare benefit plans typically do not vest; they may typically be changed or canceled at any time. (See pension plan and vested benefits).