

# CFO

## Resolving the 401(k) Fiduciary Dilemma

**How can CFOs perform their sometimes-conflicting duties to both plan participants and company shareholders?**

**Jeff Mamorsky - April 25, 2011**

**Some CFOs are questioning how long they can continue to act as retirement plan fiduciaries in light of their personal liability, but balancing conflicts of interest that can lead to being sued is not impossible.**

**The United States is the only country in the world where employers sponsoring retirement plans are also fiduciaries of their plans (other countries such as the U.K. require plans to be managed by independent trustees). That responsibility is fraught with peril. The fiduciary liability landscape has evolved over the past few years, with litigation alleging breach of ERISA fiduciary duty on the rise. Such allegations include offering inappropriate investment options to 401(k) plan participants, misrepresenting the risks of investing in employer securities, permitting excessive fees and expenses, and failing to administer plans in accordance with their terms.**

**Serving as a “Named Fiduciary” member of the 401(k) plan committee places CFOs in a precarious position, particularly because of the inherent conflict between corporate and plan fiduciary responsibility. How to use or interpret information they are aware of because of their CFO role when wearing the ERISA hat is a thorny dilemma. They also have to decide whether certain facts they know must be disclosed to plan participants.**

**While choosing not to be a plan fiduciary is one obvious solution, the importance of benefit-plan integrity to morale, recruitment, and retention has kept the CFO continuing in both roles at many companies. How, then, can potential exposure be managed effectively?**

### **Where Conflict Begins**

**While employers bear the risk of investing plan assets in pension plans, conflicts are more prevalent in 401(k) plans, especially those that offer employer stock as a participant-directed investment. There are currently more than 100 lawsuits alleging the practice was not prudent, filed after an employer’s stock price plummeted. In such cases, fiduciaries often argue that in offering these investments they were merely complying with stipulations in the plan document. Some courts and the Depart-**

ment of Labor have not agreed, since ERISA tells fiduciaries to follow plan documents only insofar as they are consistent with ERISA-prescribed fiduciary duties.



To comply with ERISA, fiduciaries of 401(k) plans that include employer stock as an investment option must show that plan decisions were objective and in the best interest of employees. However, competing fiduciary duties may arise if the plan committee includes a company officer, like the CFO, who also has a fiduciary duty to shareholders. Generally, such situations occur because the duty to shareholders to maintain a stock's value conflicts with the duty to objectively manage that same stock within an ERISA retirement plan.

### Overcoming the Dilemma

The path to mitigating fiduciary liability lies in removing discretion from the 401(k) committee by appointing an independent trustee to manage the employer stock investment option and/or using an objective decision-making methodology in place of subjective decisions. For the latter strategy, a volatility index that is predetermined and approved by the plan committee could be the basis for an objective measure of the company's stock value. All appropriate fiduciary decisions, including whether to continue the company stock offering, are driven by the results of the volatility-index analysis.

Potentially applicable volatility indexes estimate the stock's true market value based on the company's fundamental economic health and estimate the amount by which earnings should exceed or trail other companies with comparable risk. The economic-value-added (EVA) method for valuing a company is one that could be used as, or as part of, a volatility index.

A decision tree is then developed that results in a predetermined objective strategy that removes subjectivity and thus is compliant with the ERISA fiduciary requirement to act "solely" on behalf of plan participants. After the decision tree is established, the plan is actively monitored over time using the volatility index. The decision tree should include one or more action thresholds assigned as a warning trigger point — for example, a percentage drop in value at which a warning is automatically generated, allowing the plan committee or independent trustee to take additional precautions to protect participants. Many plaintiffs' law firms target a 20% drop in stock price as a threshold at which a lawsuit may be filed.

### No Mass Exodus — Yet

Despite the many lawsuits against plan fiduciaries, so far there has been no mass resignation of CFOs from their plan-fiduciary role. But many are considering the

**adoption of best-practice procedures to demonstrate objectivity where a conflict exists. As the volatile economic environment prompts more lawsuits over the loss of retirement savings invested in employer securities, CFOs who serve as plan fiduciaries should think carefully about their dual roles and whether they are prepared to manage any potential conflicts.**

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