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Hutcheson case highlights risks for advisers

Under ERISA, those guiding retirement plans as fiduciaries can be held liable for misdeeds of others

By Darla Mercado

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Financial advisers and plan sponsors, beware: If you recommend a fiduciary to perform plan services, you may be held responsible if something goes wrong.

That is the opinion of legal experts commenting on the case of high-profile 401(k) fiduciary Matthew D. Hutcheson, who was indicted April 11 on federal charges of diverting money from clients in multiple-employer plans for his own purposes. Through his attorney, he denied any wrongdoing. Details of the plan documents and his arrangements with other advisers aren't publicly available.

Mr. Hutcheson's alleged requests for wire transfers of plan assets were made to a record keeper, which then passed that order to the custodians that held the money, according to the complaint filed by the U.S. Attorney's Office for the District of Idaho.

Neither the record keeper, ASPire Financial Services LLC, nor the custodians, MG Trust Co. LLC and Charles Schwab Trust Co., are defendants in the case, but experts on the Employee Retirement Income Security Act of 1974 warn that fiduciary advisers who may have recommended Mr. Hutcheson's services to plan clients could be held responsible, as could the plan sponsors.

“If there were red flags, the sponsors are at risk and so are the advisers, and they could be held liable for the alleged breach,” said Jason C. Roberts, chief executive of the Pension Resource Institute LLC.

In the post-Madoff world, merely having plan assets held at a recognized custodian isn't enough to ensure safety, attorneys said.

“Custodian arrangements are generally good, but a criminal can figure out ways to get around it,” said Marcia Wagner, managing director at The Wagner Law Group.

“A false sense of security is rife in this industry,” she said.

“Plan sponsors can't have that sense of security. They have to ask about accounting, record keeping and how the custodian is being audited,” Ms. Wagner said.

She noted that to ensure safe handling of plan assets, establishing checks and balances among parties that work with a retirement plan “isn't just a best practice, it's essential.”

The Hutcheson case itself is a teachable moment for advisers, emphasizing the need for deep levels of due diligence when bringing other fiduciaries into a plan.

“You need to think long and hard about bringing in other advisers and parties into a plan,” said Bradford P. Campbell, counsel at Drinker Biddle & Reath LLP. “Making recommendations to plan clients about other service providers isn't something to be taken lightly.”

The federal case is playing out at a time when the Labor Department is placing greater emphasis on the disclosure of fees and services to plan sponsors and participants. Those disclosures require service providers to spell out whether they are acting as a fiduciary.

As a result, advisers who are working with plans may bring in outside expertise to handle or share certain fiduciary duties, such as discretionary plan administration. In other scenarios, advisers may be distributing multiple-employer plans and working with a third party that will act as a fiduciary to the MEP.

Enter the potential for liability.

Under ERISA, plan sponsors and advisers acting as fiduciaries to a given plan may be held liable for the missteps of other plan fiduciaries if they had knowledge of the offending party's breach and failed to remedy it, according to Mr. Roberts.

In these arrangements, the adviser should head off any questionable activity by requiring duplicate confirmations and remaining in the loop on all transactions taking place between the plan and other service providers.

“Once you're the fiduciary, you're supposed to be cognizant of what the other fiduciaries are doing,” Mr. Roberts said.

If the adviser working with a given plan isn't a fiduciary but recommends other third parties to take on fiduciary responsibilities, the referring adviser still may face fee disgorgement orders from the Labor Department if the recommended fiduciary misbehaves and the broker has undisclosed conflicts of interest with that party.

Seeking to avoid this risk, particularly as plan-focused advisers shift their business to a fee-based model that will let them act as fiduciaries, broker-dealers have stepped up their efforts to keep informed of transactions taking place between retirement plan clients and other parties.

“Our advisers don't take discretion or act as an [ERISA Section 3(38)] investment manager unless they clear through our platform with National Financial Services LLC,” said Paul Mahan, director of retirement consulting services at Commonwealth Financial Network.

The firm performs due diligence on service providers and 401(k) managers, and requires that every consulting agreement between a plan and a fee-based adviser thoroughly detail what an adviser will and won't provide.

The paperwork is just as detailed for commission-based registered representatives who have plan clients, Mr. Mahan said.

Interestingly, while broker-dealers and their advisers are at risk in cases involving malfeasance by an outside fiduciary, custodians and record keepers generally aren't held to the same level of responsibility, ERISA experts said.

For example, if a fiduciary to a retirement plan has discretion over the plan's assets and makes a request to the record keeper for liquidation or asset transfer from the plan account at the custodian, the record keeper and custodian aren't held responsible under ERISA, as they are following orders from a plan fiduciary and aren't fiduciaries, Mr. Roberts said.

Still, some custodians have established a system of checks and balances, spelling out these details in contracts with plan clients.

“If a third-party administrator chosen by an adviser sends us a wire request for a liquidation, we can't honor it,” said Frederick A. Van Den Abbeel, executive vice president of RIA services at Trade-PMR Inc.

Meanwhile the case against Mr. Hutcheson is proceeding along two “branches,” said his attorney, Dennis M. Charney.

“One branch alleges Matt used investor funds for personal expenses; that allegation is denied in its entirety,” Mr. Charney wrote in an e-mail. “The other branch alleges Matt used investor funds to invest in the Osprey Meadows golf course. Matt, under ERISA, had full discretion to do so. Thus, this activity was not criminal in nature and we intend to fully defend all the allegations in court.”

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