PlanPILOT

Better Outcomes, Less Risk

Who is a Fiduciary?

Asking the Right Questions to Ensure Intentional Fiduciary Roles

EXECUTIVE SUMMARY

Retirement plan sponsors are faced with the heightened importance to understand the fiduciary role & responsibilities. An increased standard of care has existed under ERISA for many years. More recently, there is increased uncertainty over the now defunct DOL rule, the SEC's best interest standard under development, and the potential for further regulatory replacements. Couple that with the proliferation of litigation involving the oversight of services and fees and it's easy to understand why there is an expanded and uncertain potential for liability of the fiduciary.

Plan sponsors need to carefully identify who its plan fiduciaries are and make sure those fiduciaries are aware of their role, properly trained and effectively monitored in the exercise of their increasingly complex role. The following questions and answers will help you determine whether you have effectively determined and implemented your retirement plan oversight roles in ways that can improve the management of your fiduciary risk exposures.

Just Who is a Fiduciary?

There are various ways someone can become a retirement plan fiduciary. These can occur by title or position held, functions performed and by appointment. It is entirely possible to become a fiduciary without necessarily choosing the role. A plan sponsor and its retirement plan committee need to be able to identify everyone who falls into the following roles.

The plan sponsor always has responsibility for the effective set-up and operation of its retirement plan. ERISA requires the plan sponsor to have a "named fiduciary" or "plan administrator." Typically, this will be the retirement plan committee or perhaps officers by virtue of their position held. The named fiduciary must be identified in the summary plan description that is provided to the participants.

Another way to become a fiduciary is to be "deemed" one by the role performed. This qualification involves anyone who renders investment advice on a regular basis intending it to be used as the basis for decisions and provided for compensation, as well as anyone who has the power to exercise discretionary authority over management or disposition of assets.

- If the retirement plan committee was not identified as the "named fiduciary," certainly they would become a fiduciary by virtue of the authority they have over the plan's assets.

- A retirement plan consultant would also perform in this capacity by virtue of giving investment advice. This role is known as an investment "adviser" under Section 3(21).

A further method of becoming a fiduciary is through "appointment." This occurs in this fashion:

- Committee grants discretionary authority to manage assets to an outside entity.
- The entity must be a Registered Investment Adviser, bank or insurance company.
- The adviser must acknowledge its status in writing.

In this case, the fiduciary responsibility shifts from the committee to the manager. This role is known as an investment "manager" under Section 3(38). Retirement plan consultants are increasingly taking on this position.

Still one more way of taking on some level of responsibility is through the role of a broker. While a consultant will more directly and openly perform as a **3(21) adviser** or **3(38) manager** and accept the attendant responsibilities, a broker may not rise to that level.

- A broker is more likely to perform a transactional or periodic role. This could include a one-time revamping of an investment line-up or replacing an underperforming fund option. Unless the actions are on a regular basis and for compensation, the broker role does not rise to the level of a fiduciary.
- In this case, the broker is held to the standard of making suitable recommendations that match the needs and objectives of the plan.
- Not being at the level of a fiduciary, a broker may be more able to include proprietary products and commission compensation than a consultant performing in a fiduciary capacity.

One other role to note is that of wealth management. These investment and financial planning services are provided to the participants. An entity that provides wealth management services for individual participants has a level of responsibility to the participant.

- If the advisory services are performed inside the plan, such as a managed account or participant advice solution, then the wealth manager will likely be a fiduciary.

- If the services are performed outside the plan, such as an IRA rollover, the wealth manager is not a plan fiduciary, but may be held to the best interest standards of the SEC (surviving the former DOL rule). This standard is based on an enhanced construction of the suitability standard that governs brokers and is current being scrutinized.

3(21) Adviser vs. 3(38) Manager

The plan sponsor and retirement plan committee need to carefully identify which role its service providers fulfill as that impacts the potential liability of the sponsor and committee. The consultant providing the services should have a clear understanding of its role.

3(21) Adviser

- The adviser makes recommendations to the committee.
- The committee makes and implements the decisions.
- The committee retains responsibility for the decisions and their outcomes.
- The adviser is a co-fiduciary for the advice given, but not responsible for the decisions made and the results that follow from choices made by the committee.

3(38) Manager

- The manager has full discretion to provide asset management for the committee and plan.
- The liability shifts from the committee to the manager for the investment execution.
- The committee is not responsible for the decisions made and their outcomes.
- The committee retains liability for the selection and on-going monitoring of the manager, including reasonableness of fees.

Which is Best For Your Plan?

The plan sponsor and committee need to consider which is the best fit for their plan. These considerations include the following.

The fiduciary risk transfers under 3(38) to the manager. The sponsor and committee retain responsibility for the oversight of the manager. While this is attractive, the sponsor and committee need to ask itself:

- Are we comfortable letting go of control of the investment decision making? While there will be investment guidelines that provide a roadmap and guardrails for the manager, the manager will have full discretion within those parameters.

- Do we possess the ability to perform effective due diligence over the manager, or do we need to hire someone to periodically provide this oversight? This role must be carefully performed and documented, including the reasonableness of the fees being charged.

The sponsor and/or committee also needs to consider how it functions operationally.

- Do we have a committee, do we have investment/financial expertise on the committee, do we meet regularly, do we make effective and timely decision making? If these are primarily yes, then a 3(21) adviser may make more sense.

- Conversely, do we not have a committee, do we not have investment/financial expertise on the committee, do we not meet regularly, do we have difficulty making decisions or take a protracted time for implementation (especially important for underperforming options)? If this is the case, then a 3(38) manager is advisable.

Other benefits of a 3(38) manager include freeing-up the committee to focus on bigger picture matters, such as:

- Plan design
- Plan performance
- Retirement readiness of participants
- Education and participant communications.

Managing the details of the investment program is complex and time consuming. Proper expertise needs to be in place and working effectively.

Watch Senior Consultant Frank Szymanek delve more about the different types of fiduciary roles and their responsibilities.

Core Fiduciary Responsibilities

Having intentionally identified the fiduciaries and their level of authority and responsibility, a plan sponsor and its fiduciaries should be aware of the duties the role entails. Fiduciaries need to be properly trained and effectively monitored in the exercise of their increasingly complex role.

ERISA Plans

- For plans governed by ERISA, the following are the core fiduciary responsibilities:

- Duty to act prudently - Fiduciaries must use the care, skill, prudence, and diligence of that of a prudent person *acting in a like capacity and familiar with such matters* would use in similar circumstances.

- Duty to act with loyalty and for the exclusive benefit of participants and beneficiaries - Fiduciaries must act solely in the interest of and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.

- Duty to diversify plan assets - Fiduciaries must diversify plan assets so as to minimize the risk of large losses.

- Duty to act in accordance with the plan's governing documents - Fiduciaries must act in accordance with the documents governing the plan (to the extent that they are consistent with ERISA).

Non-ERISA Plans

For any plan **not** governed by ERISA, such as a plan maintained by a church or public entity, the ERISA standards still provide best practices for fiduciary oversight. The main difference is in the duty to act prudently. A non-ERISA fiduciary should use the care, skill, prudence, and diligence of that of a reasonable person, which is less than the prudent expert requirement of ERISA. The remaining elements to act in the best interests of participants, diversify assets and operate according to a plan document continue to be best practices.

Brokers

In contrast, recall that a broker whose role does not rise to the level of fiduciary is held to the standard of suitability in its recommendations. Not being at the level of a fiduciary, a broker may be freer to include proprietary products and commission compensation in its recommendations than a consultant performing in a fiduciary capacity.

Wealth Management

One other role to be distinguished is that of the wealth manager. This role involves investment and financial planning services provided to the participants as retail customers. When these services are performed outside the plan, such as an IRA rollover, the wealth manager is not a plan fiduciary, but will potentially be held to the best interest standard under development by the SEC (surviving the now defunct DOL rule; it is unclear whether the DOL or states may jump in with other fiduciary standards in the future).

As its name implies, the best interest standard of conduct explicitly requires the wealth manager to act in the best interest of the customer and put the interests of the customer ahead of itself. It further requires the person making the recommendation to exercise reasonable diligence, care, skill and prudence to form a reasonable basis for any recommendation made. This standard is similar to the fiduciary standards discussed above, but is not to the level of a fiduciary. From another perspective, it is an enhancement of the suitability standard that already exists for non-fiduciary brokers. It is currently being evaluated.

CONCLUSION

The role of the fiduciary is expanding and is uncertain given regulatory and litigation developments. A plan sponsor needs to carefully identify who its plan fiduciaries are and make sure those fiduciaries are aware of their role, properly trained and effectively monitored in the exercise of their increasingly complex role. The plan sponsor needs to make the selections within those responsibilities that best fit the institution to improve the management of its fiduciary risk exposures.

An expert retirement plan consultant can assist the plan sponsor and its fiduciaries in managing their challenges and risks effectively. A consultant will share in the fiduciary responsibilities.

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