Why Retirement Plan Sponsors Should Be Careful About Buying "Fiduciary Services"

By Ary Rosenbaum, Esq.

When I was a kid, going to the supermarket seemed easier than it is today. Sure, we had no UPC scanners at checkout, but it seemed we needed less time to shop because we had less choice. Back in those days, we had one variety of Cheerios, one variety of Tide, and life was OK (except for the stagflation days of the late 1970s). These days we seem to have about a dozen or so varieties of Cheerios and enough varieties of Tide for its very own aisle. I remember there used to be only form of Listerine that came in a wrapped glass bottle. Gargling that stuff was like gargling gasoline. So over the years, they added more varieties and concoctions of it. So a few weeks back, I purchased their Listerine Zero because it has no alcohol and was less intense than the original formula. The problem is that after buying it, I noticed that it didn't fight against plaque or gingivitis. It only killed germs that caused bad breath. So I got that going for me. A mouthwash without plaque protection is like beer without alcohol. The point of this supermarket history is to point out that despite the fact the product is named Listerine; you actually have to look closely at the label to make sure that you are getting what you are expecting. The same thing goes for plan sponsors in buying plan services especially when using the word, fiduciary.

Many of the actions involved in operating a plan make the person or entity performing them a fiduciary. The fiduciary status is based on the functions performed for the plan, not just a person's title. A plan sponsor is a fiduciary, so are the individual trustees. A fiduciary duty is the highest standard of care at either equity or law. A plan fiduciary is expected to be extremely loyal to the plan and a breach of that fiduciary duty may involve personal liability. Since the duty of a plan fiduciary is extremely important, plan sponsors need to hire plan providers that will help minimize that potential liability. One of the ways to minimize that liability other than best practices is to hire a financial advisor that will serve in a plan fiduciary role as well, so that advisor will either stand in the shoes of or stand next to the plan fiduciaries. Having an advisor serving is a fiduciary is a great way for the plan sponsor to spread the blame and liability when they get sued by plan participants. The problem is that many plan sponsors think when they are getting a plan provider offering "fiduciary services" is that they are getting someone serving in a fiduciary capacity. Too often, they found that not be the case the hard way, in a court of law.

When it comes to retirement plans, the use of the word fiduciary is so over used in the marketplace that it becomes as generic as the Band-Aid brand. So while plan sponsors are hearing the word fiduciary thrown around in products and services, it creates an expectation that may not be met because while they are toting fiduciary services, the product is missing the fiduciary protection that plan sponsors assumes that it has. So while plan providers can use the term as freely as they want, plan sponsors need to know that there is a difference between someone serving in a fiduciary role or someone whois not. So this article will try to let plan sponsors know what the term fiduciary really means and what products and services there don't offer the fiduciary liability protection that plan sponsors assume they are getting.

Current law imposes a five-part test that must be satisfied in order for a person or an entity to be treated as a fiduciary by reason of rendering investment advice. Advice is considered "investment advice" if an adviser who does not have discretionary authority or control with respect to the purchase or sale of securities or other property for the plan:

1. renders advice as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing or selling securities or other property
2. on a regular basis
3. pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary, that
4. the advice will serve as a primary basis for investment decisions with respect to plan assets, and that
5. the advice will be individualized based on the particular needs of the plan.

Under the current definition, stock brokers are not plan fiduciaries since providing advice on a regular basis is not considered the role of a stock broker. While the Department of Labor is trying to change that fiduciary definition and require brokers to be fiduciaries, it should be noted that while they may called themselves retirement plan advisors, they will not serve the plan in any fiduciary capacity.

Registered investment advisors (RIAs) can serve in a co-fiduciary capacity, or as an ERISA §3(21) or ERISA §3(38) fiduciary. A co-fiduciary capacity means that the RIA will serve in a capacity alongside the plan fiduciaries and will share in the liability. An ERISA §3(38) fiduciary will assume the entire fiduciary process and therefore almost all of the fiduciary liability. A limited scope §3(21) fiduciary has no discretionary authority and offers the same liability protection as a co-fiduciary. A full scope §3(21) fiduciary has discretion and offers almost the same liability protection as an ERISA §3(38) except the full scope §3(21) can hire and fire other service providers. When hiring an RIA, a plan sponsor should determine what type of fiduciary role that they will serve which shall determine the liability protection. Plan sponsors should always be wary of RIAs trying to disclaim any fiduciary role by hiding such language in their contracts (I know, I worked for one). A good ERISA attorney (cough, cough) can certainly help in reviewing these agreements and breaking them down in English.

The word warranty in business carries great importance such as a 5 year /50,000 mile warranty for new cars. Of course, as with any warranty, there are terms and conditions that limit that warranty that people who don't read the fine print find out in most unfortunate circumstances that they won't be covered. Many insurance companies who operate as retirement plan providers have been offering what they call a "fiduciary warranty".

When plan sponsors will hear the term "fiduciary warranty", they will assume that these plan providers will either serve in some sort of a fiduciary capacity or indemnify the plan sponsor in any lawsuits brought by plan participants for any claim for a breach of fiduciary duty. Of course, these providers go out of their way to make sure that they are not identified as serving in any fiduciary capacity and the fine print in these warranties indicate that the providers will only defend plan sponsors in only in rare instances. The warranties only protect the plan sponsor under the ERISA §404(c) requirement of offering a "broad range of investment alternatives", and that the investment strategies provide a suitable basis for plan participants to construct well diversified portfolios. To comply with the simple broad range requirement, the plan fiduciaries must first decide on the asset classes (e.g., stocks and bonds) and styles (e.g., large cap U.S. equity growth fund, small cap U.S. equity value) for the "core" investments of the plan. So plan sponsors need to offer a diverse group of investments.

Guaranteeing that the investments offered in the plan are part of a broad range of investments and are prudent is one of many ways where a plan fiduciary can be sued for an ERISA Section §404(c) breach. A plan sponsor and fiduciary can still be sued for not formulating an investment policy statement or offering investment education to plan participants. That whole broad range requirement is rather broad; I am unaware of any plan fiduciaries ever being sued on that requirement. A fiduciary warranty is almost absolutely no protection for plan fiduciaries, it's like buying car insurance that only covers you in a head on collision or a life insurance policy that only pays on accidental death. It's a warranty that guarantees very little. The fiduciary warranty s no substitute for an ERISA §3(21) or ERISA §3(38) fiduciary or a co-fiduciary.

Many plan providers such as payroll provider TPAs are also now offering "fiduciary services" being provided by a third party. What are these services? Are they really serving in a fiduciary capacity or are they just providing services to a fiduciary? Providing services to a fiduciary could be just assistance in managing the fiduciary process such as helping with education to plan participants with the investment policy statements. Fiduciary assistance is different from being a fiduciary, just like juice is juice and a juice beverage is watered down juice. When it comes to any provider adding anything to the back of the word fiduciary, it probably means what they are offering is not any fiduciary role which means that plan sponsors are getting less liability protection than they think.

Having a retirement plan provider serving in a fiduciary role does minimize the liability that plan sponsors and trustees have as since the provider will share or assume all the fiduciary liability that was originally intended for them. The plan sponsor needs to get beyond the marketing and deceptive terms that some providers are touting services that are well short of a fiduciary role. Plan sponsors need to know what they are getting because nothing is worse than suing a plan provider and a court ruling that the provider was never a plan fiduciary.

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