The Value Of A Good ERISA Fiduciary

By Ary Rosenbaum, Esq.

Hot potato is a party game that involves players gathering in a circle and tossing a small object such as a beanbag or tennis ball to each other while music plays. The player who is holding the "hot potato" when the music stops, is out. Unfortunately, when it comes to retirement plan hot potato, fiduciary responsibility may be passed around, but usually the plan sponsor is holding the fiduciary responsibility bag. As Uncle Ben told Peter Parker before he became Spiderman, “with great power comes great responsibility.” Sponsoring a retirement plan for the benefit of their employees is a great power, but being a fiduciary is a great responsibility. With fiduciary responsibility, comes potential liability.

As a general rule, a person is a fiduciary of an employee benefit plan if they meet any one of the following tests: they exercise discretionary authority or control over plan assets or plan management; they are specifically identified in the written documents of a plan as a named fiduciary; they have discretionary responsibility in the administration of the plan; or they manage the plan or render investment advice for a fee. A plan sponsor and plan trustees are fiduciaries and a breach of fiduciary responsibility can involve personal liability. Fiduciaries have important responsibilities and are subject to standards of conduct because they act on behalf of participants in a retirement plan. These responsibilities include: acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them; carrying out their duties prudently; following the plan documents (unless inconsistent with ERISA); diversifying plan investments; and paying only reasonable plan expenses. The potential liability as a fiduciary can be minimized, but it can almost never be fully eliminated.

Liability as a fiduciary can be minimized through good practices such as an ERISA

bond, fiduciary liability insurance, and hiring retirement professionals such as a third party administration firm (TPA), financial advisor, and an ERISA attorney. The problem is that even hiring professionals won’t eliminate liability, so plan fiduciaries have learned the hard way when the TPA wasn’t doing their job, the financial advisor was running a ponzi scheme, and the ERISA attorney hadn’t updated the plan document since the Reagan administration.

Over the last dozen years and two bear markets, there has been a large upswing in lawsuits against plan fiduciaries because when times are rough, plan participants need someone to blame someone for the losses in retirement savings and that someone are plan sponsors and trustees in their role as fiduciaries. Plan sponsors and trustees have been sued by plan participants who directed their own investments because plan fiduciaries did not follow the ERISA 404(c) process of selecting directed investments by not developing an investment policy statement (IPS) or by not reviewing the investments options against the IPS. Plan sponsors and trustees have also been held to breach their fiduciary responsibility for excessive plan costs even though there was no requirement for the plan providers to reveal the cost of administering the plan. In a recent case in California, a plan sponsor was held to have violated the fiduciary responsibility of prudence simply because participants were paying for retail mutual funds in their 401(k) plan, while the “wholesale” less expensive, institutional class of the same mutual funds was available. Since the role of a plan fiduciary comes with many pitfalls, there has been a need to develop a program that will relieve plan fiduciaries of the burden of being fully responsible for things that they do not have the background to understand and control.

In the last few years, one of the greatest developments in the retirement plan industry has been the development of the independent ERISA fiduciary, where experienced financial advisors who are well educated in the running of retirement plans have added that role to their services at an additional fee. While having a financial advisor acts as a fiduciary is a concierge like service, all ERISA fiduciaries are not created equal and plan sponsors may be paying something that they are not actually getting.

There are two types of ERISA fiduciary roles that an advisor may take on and there is a major difference between what is called an ERISA 3(38) and an ERISA 3(21) fiduciary. An ERISA 3(38) is the Cadillac of fiduciaries because when a plan sponsor selects an ERISA 3(38) defined investment manager, that investment manager becomes an ERISA defined "independent fiduciary," which has some significance. It should be noted that an ERISA 3(38) fiduciary can only be a bank, insurance company, or a registered investment advisor.

I call the ERISA 3(38) fiduciary, the Cadillac of ERISA fiduciaries because an ERISA 3(38) fiduciary has ERISA legally defined "discretion." By having that discretion, an ERISA 3(38) fiduciary fully assumes the decision making process and liability from the plan sponsor in the selection of investments for participant directed 401(k) plans. While the plan sponsor will be consulted by a good ERISA 3(38) fiduciary, the fiduciary will have fiduciary responsibility and liability in developing an IPS while monitoring, selecting, and replacing plan investments against that IPS. As previously discussed, plan sponsors have been sued by participants over the process in selecting investments for participant directed plans and the appointment of ERISA 3(38) fiduciary will eliminate that risk. Of course, if the plan sponsor wants to replace the ERISA 3(38) fiduciary, the plan sponsor will regain the fiduciary responsibility and liability that the fiduciary held.

While the ERISA 3(38) fiduciary is the Cadillac of fiduciaries in my mind, the ERISA (3)(21) fiduciary is the Chevrolet of fiduciaries. Unlike the discretionary role that an ERISA 3(38) assumes as a fiduciary, an ERISA 3(21) makes nondiscretionary recommendation on plan investments to plan sponsors and trustees. By making these recommendations and not the actual decisions, an ERISA 3(21) does not assume the full fiduciary responsibility that an ERISA (3)(38) fiduciary does. An ERISA 3(21) fiduciary acknowledges their fiduciary role, but the plan sponsor is on the hook for making the investment decisions.

There is also a difference between what is called a limited scope and full scope ERISA 3(21) fiduciary. A limited scope ERISA 3(21) is one who acknowledges a fiduciary role without taking discretion; they provide investment advice, but leave the ultimate decision to the plan sponsor. A full scope ERISA 3(21) or Named Fiduciary, as delegated by the plan sponsor, has complete discretion and has the ultimate authority over a plan (as well as assuming more fiduciary responsibility).

Unfortunately when plan sponsors hears insurance company providers or ERISA 3(21) offering fiduciary services without fully describing that role, plan sponsors and trustees assume that they have been fully relieved of the burden of fiduciary responsibility. Plan sponsor should always determine what fiduciary responsibility and liability any person claiming to be a fiduciary or co-fiduciary will assume. If they don't, they may be in for a surprise.

Why the need for a good ERISA fiduciary? It depends on the plan sponsor. A plan sponsor who decides that they aren't experts in being fiduciaries and would rather let professional advisors handle the role and liability at a cost will use a professional fiduciary. Hiring an ERISA fiduciary is more expensive than hiring a financial advisor because of the liability involved that an ERISA fiduciary will assume. There is a tremendous benefit in hiring a good ERISA fiduciary because plans that hire one don't seem to have the problems that plague most plans such as poor investment choices, high administration fees, and poor investment education to participants. Plans with independent ERISA fiduciaries also get sued less.

A plan sponsor may be off the hook as a fiduciary by using an ERISA fiduciary, they are not off the hook for hiring one. It is incumbent on the plan sponsor and trustees to develop a vetting process in the hiring of an ERISA fiduciary because they will be liable for hiring the Bernie Madoff of ERISA fiduciaries. Hiring an ERISA fiduciary is an important decision; hiring an experienced and professional ERISA fiduciary is even more important.

While an ERISA 3(38) fiduciary is the clear choice for plan sponsors that want out of the plan fiduciary business, ERISA 3(21) fiduciaries do offer some value as well. It is up to the plan sponsor and trustees to determine how much their peace of mind is worth and whether that cost is the same cost as hiring an ERISA fiduciary.

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