Breaking the Code of ERISA Fiduciaries: A Plan Sponsor's Guide

By Ary Rosenbaum, Esq.

When you are purchasing a home computer these days, it can often be confusing if you are not well versed in the jargon. While selecting between a Mac and a PC or a laptop vs. a desktop is easy, the other details can be confusing. What type of processor, how much space the hard drive (or a solid state drive if it's an Ultrabook) has, how much Gigahertz does it have, as well as gigabytes of memory RAM can lead any layperson crazy. When it comes to retirement plans these days, just as confusing is the different types of fiduciary services that are being offered to plan sponsors like 3(16), 3(21), or 3(38). So while these numbers look like biblical passages, they offer different levels of protection so a plan sponsor may be confused on what they are actually buying. There is nothing worse to assume you are buying a level of fiduciary protection that you are not really getting. So this article is intended to act as a guide for plan sponsors so they can tell the difference between the different levels of fiduciaries so that they can make sure they are getting the liability protection for what they are paying for.

What is a plan 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 plan provider that will serve in a plan fiduciary role as well, so that the provider will either stand in the shoes of or stand next to the plan fiduciaries. Having a provider 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.

Brokers

Based on the current Department of Labor definition for plan fiduciaries, stock brokers have been able to skirt being a fiduciary. Brokers were able to skirt the application of the fiduciary rule by arguing that they only rendered advice from time to time and that their advice wasn't the primary basis for the plan's investments. Since stock brokers sell financial products and owe no fiduciary duty of care to the plan, they can sell financial products that benefit themselves more than it benefits the plan sponsor. This is not to suggest that brokers are unscrupulous, it is just to note that they currently do not owe the same duty of care that a registered investment advisor (RIA) owes to the plan sponsor. RIAs don't have such issues since they don't sell financial products. In terms of lawsuits for fiduciary liability, an RIA will sit at the defendant's table as a co-defendant with the plan sponsor, while the broker doesn't have to be in the courtroom. So while brokers may make claims of their responsibility, any claims that they serve in a fiduciary capacity isn't true, at least now.

Co-Fiduciaries

Without using an ERISA number, registered investment advisors acting as a plan's retirement advisor and other plan providers who want to acknowledge that role, are co-fiduciaries of the plan they work on. While they acknowledge their role as plan fiduciaries, what does that really means? Well, it's supposed to mean that your financial advisor will take some of the liability if you get sued as a plan sponsor if there is an alleged breach of the fiduciary process. Most advisors who taken on this role are sincere in taking on the liability that is connected with being a co-fiduciary. However, there are some that can play 3 card monte with it and while they claim they take on a co-fiduciary role, their contract with the plan sponsors says differently. So a plan sponsor needs to read their service agreement with their co-fiduciary financial advisor to ensure what that claim of co-fiduciary really means.

ERISA §3(16) Plan Administrator

One of the growing businesses for retirement plans this year will be third party administration (TPA) firms touting an

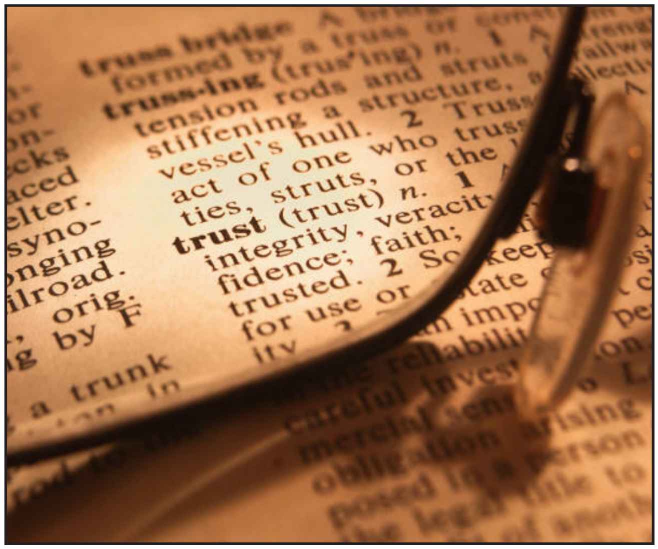
ERISA §(3)(16) administration service. So what's the big deal? The "Plan Administrator" of a qualified retirement plan is defined in section 3(16) of ERISA. The Plan Administrator should is not the same as a "Third Party Administrator" because a Section 3(16) administrator is a "first party" administrator.

The Plan Administrator has the job of ensuring that all filings with the federal government (form 5500, etc.) are timely made; make the required and important disclosures to plan participants; hire plan service providers if no other fiduciary has that responsibility; and fulfilling other responsibilities as set forth in plan documents. The ERISA § 3(16) administrator is a plan fiduciary and assumes the liability that comes with it, however they have no direction is selecting plan investments like the Cadillac of fiduciaries does, but more about later.

ERISA §(3)(21) Fiduciary

An ERISA §(3)(21) fiduciary is basically a financial advisor who takes on the role of a fiduciary, as defined in ERISA §(3)(21). While these advisors take all of the liability of being an ERISA §(3)(21) fiduciary, they have no discretion in selecting plan investments and handling the fiduciary process, the plan sponsor still has the final say. That means that despite all the code sections, plan sponsors will still be held liable for any breach of fiduciary duty in the fiduciary process such as the development of an investment policy statement (IPS), review of investment options, and participant education.. These limited scope ERISA §3(21) fiduciaries have limited scope because they have limited decision making because the buck still remains with the plan sponsor.

Another concept that is distinct is what is called a full scope ERISA §3(21) fiduciary, which is something of a marketing creation. It is much different than a limited scope §3(21) fiduciary. A full scope ERISA 3(21) takes the role of the Named Fiduciary and has complete discretion and effectively assumes responsibility for the management and operation of the plan. That would include all investment management decisions unless an ERISA §3(38) fiduciary or a limited scope ERISA §3(21) fiduciary has been appointed. The Full Scope 3(21) Named Fiduciary is responsible for hiring, monitoring and replacing all other service providers. So if a full scope ERISA §(3)(21) fiduciary is appointed by a plan sponsor, the only responsibility the plan sponsor retains is the proper selection and monitoring of that full scope/ Named Fiduciary.



ERISA §3(38) Fiduciary

In the number soup of ERISA fiduciaries, it is clear that the ERISA §3(38) fiduciary is the Cadillac of ERISA fiduciaries. There is nothing wrong with driving a Buick or a Chevrolet, but the fact is that the 3(38) offers the plan sponsor the most form of liability protection. An ERISA §3(38) fiduciary is the ERISA defined "Investment Manager", which is defined in Section 3(38) of ERISA. The Investment Manager becomes "solely" responsible for the selection, monitoring and replacement of plan investment options, as well as all aspects of the fiduciary process such as developing the IPS and offering participant education. So in this structure, the Plan Sponsor and other plan fiduciaries are relieved of the responsibility for the Investment Manager's decisions. However, the plan sponsor retains a residual duty to prudently select the Investment Manager and make sure they are carrying out their appointed duties. So if one day, there is a Bernie Madoff of ERISA §3(38) fiduciaries (and there likely may be one), the plans sponsor is on the hook for making that hire.

Since there is a lot of marketing in the retirement plan space, I have been advised that there are a couple of folks advertising a "limited scope" ERISA §3(38) fiduciaries. Sorry, Virginia, there is no such thing as a limited scope §3(38) fiduciary. Being an ERISA defined Investment Manager makes you full scope and any opportunity to devalue that role doesn't make it a real 3(38). Hiring someone who calls themselves a limited scope §3(38) fiduciary is like a fireman who doesn't extinguish flames.

Advertising is a great medium and it's a medium that could often be confusing to the consumer. So when it comes to the retirement plan business, you have providers providing fiduciary services whether that's 3(16), 3(21), 3(38), co-fiduciary, or the generic fiduciary services. Of course, let's not forget that fiduciary warranty, that is neither a fiduciary or a wide ranging warranty. So while people concentrate on numbers and names, plan sponsors should focus more on what these providers are promising in their contracts. Kosher style isn't kosher and a 3(16), 3(21), or 3(38) service without the requisite duties and liabilities that come with it isn't the service they claim. So a plan sponsor should review what types of service are being promised by actually reading the contracts. If they can't make heads or tails, then hire an ERISA attorney (cough, cough) who can.

There is nothing worse in buying a service that really isn't what it says it is.

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