The Value Of A Good ERISA Fiduciary

By Ary Rosenbaum, Esq.

Delegating is all about shifting responsibilities to someone else to handle something that we don't want to do or can't do. That could be something as simple as taking out food from a restaurant or hiring an electrician. When it comes to serving as a retirement plan sponsor, you can delegate some of your responsibilities by hiring a third party administrator (TPA) or a financial advisor, but the responsibility you have as a plan sponsor typically can't be delegated unless you hire someone who will assume some or all of the fiduciary responsibility in running this plan. So this article is about the value of hiring a financial advisor who will serve as an ERISA fiduciary for your plan.

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 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 investment options against the IPS. Plan sponsors and trustees have also been held to breach their fiduciary responsibility for excessive plan costs even though (prior to the fee disclosure regulations) 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 were 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 don't 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 no additional fee. While having a financial advisor act, 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. The numbers they use cone from actual sections of ERISA. 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 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 removing plan investment options 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 an ERISA 3(38) fiduciary will almost 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 Buick 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.

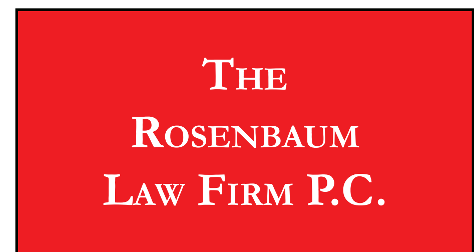
There is also a difference between what is called a limited scope and full scope ERISA 3(21) fiduciary. A limited scope ERISA 3(21) is one who acknowledges a fiduciary role without taking discretion; they provide investment advice, but leave the ultimate decision to the plan sponsor. A full scope ERISA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

Unfortunately when plan sponsors hears some providers offering fiduciary services without fully describing that role or fiduciary warranties, plan sponsors and trustees assume that they have been relieved of the burden of fiduciary responsibility. Plan sponsors 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. So it's important to review all the materials and service contracts presented by an ERISA fiduciary to make sure they are offering what they promise in breadth of services and the liability they are willing to assume. In addition, you also need to make sure that the advisor serving in a fiduciary role has the background to serve in that role as there have been many inexperienced advisors seeking out that ERISA fiduciary space to expand their practice,

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 the field and would rather let professional advisors handle the role and liability at a competitive cost will use a professional fiduciary. Despite the fact that an ERISA fiduciary is assuming a larger part of the fiduciary liability than a typical financial advisor/broker, these ERISA fiduciaries do so at management fee rates as much or if not, less than what most retirement plan financial advisors charge. 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 tremendous 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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