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Unscrambling Fiduciary Confusion

Who are your Plan fiduciaries?

Beware and Be Prepared: Ignorance is no Defense.

An Article for Plan Sponsors, Plan Officials, Administrators, Committee Members and Interested Parties

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Introduction – There are Many Fiduciary Roles, Which Can Be Confusing and Confusion Creates Liability

Plan sponsors, officials, administrators (not to be confused with a third party administrator or "TPA") and Committee members need to identify the individuals and entities that serve as fiduciaries, and understand their respective responsibilities to their retirement Plan. Equally important is the selection of service providers whose interests and function need to be well aligned with that of the Plan sponsor and the Plan. Plan sponsors and officials must understand and know when they are exposed to fiduciary liability as a Plan official, or even personally exposed to liability in certain instances, and when the Plan's service providers accept a fiduciary role.

It is important to understand these fiduciary relationships and roles, because hiring a fiduciary willing and qualified to take on the majority of fiduciary responsibility can relieve the Plan officials from some of that responsibility, so that executives and staff can focus their time and energy on running their business and not their retirement Plan. The Plan can be directed to pay for some or all of the expense for an outside fiduciary's services. A competent candidate should serve to improve Plan value, participant outcomes and reduce overall liability for the Plan sponsor and Plan officials.

Very often confused, misapplied, misrepresented and misunderstood are the roles and responsibilities of Plan fiduciaries, the actual identity of the individuals or entities who are fiduciaries, and the rules that apply to fiduciaries under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Because of these

misapprehensions, it is often necessary for Plan officials to rely upon the expertise of others to assist them. Nevertheless, Plan fiduciaries, whether individuals or entities, must be identified and their roles and responsibilities need to be well understood and adhered to.

In this Article, we will identify the various categories of fiduciary relationships that apply to retirement Plans, referring mostly to the 401(k) retirement Plan. This article is designed to aid Plan sponsors and officials in understanding their role, and the role of their Plan service providers. It is important for Plan sponsors to understand whether their providers are accepting a fiduciary role and if so, what the service providers are actually providing in terms of relative value. It is equally important for sponsors and Plan officials to be armed with the information needed to assess the risks and allocate and authorize the fiduciary responsibilities accordingly, so they can focus on their businesses and not on their 401(k) Plan.

To provide some clarity, this article focuses on the various fiduciary positions in an overview fashion. The many fiduciary roles that are often discussed and written about, which are often confused and misapprehended, include the following:

- The "3(21)" Discretionary Fiduciary For Management of the Plan and/or Assets
- The "Functional Fiduciary"
- The "Named Fiduciary"
- The "Co-Fiduciary"
- The "Trustee"
- The "3(16)" Plan Administrator
- The "3(38)" Investment Manager Fiduciary
- The "3(21)" Non-Discretionary Fiduciary, Investment Advisors
- The "Fiduciary Adviser" and Other Advisors Providing Participant Advice

Within each topic, we address the limits that are often overlooked in these roles. We also address how the fiduciary function/scope is never an all or nothing proposition. It is important to both understand the identity and responsibility of fiduciaries as well as the limitations and gaps that may exist. Our intent is to aid the reader in understanding the various fiduciary and non-fiduciary roles associated with the Plan, and assist the reader in working towards improving their understanding of the various fiduciary lines of authority and structure, to reduce risk and improve Plan operations.

The “3(21)” Discretionary Fiduciary for Management of the Plan and/or Assets

ERISA Section 3(21) provides the foundation of the identification of the fiduciaries who are responsible and liable to a Plan. This section of ERISA, at subpart A, provides that a person (defined to include entities) is a fiduciary with respect to a Plan to the extent:

- **(i)** he (or she or it) exercises any discretionary authority or discretionary control respecting management of such Plan or exercises any authority or control respecting management or disposition of its assets;
- **(ii)** he (or she or it) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such Plan, or has any authority or responsibility to do so; or
- **(iii)** he (or she or it) has any discretionary authority or discretionary responsibility in the administration of such Plan. Such term includes any person designated under section 405(c)(1)(B)(the person designated by the Named Fiduciary).

The “who” that can serve as a fiduciary under ERISA is broad and can be any person or entity. Watch out for corporations, because some may not have the requisite corporate authority to act in this capacity. Yet, under ERISA, this role is interpreted broadly. Also watch out for potential personal exposure, when you may think that a corporation is the fiduciary, but it is actually an employee or plan official employed by that corporation!

The “what” is the fiduciary function, really comes down to several things. First, it is always “to the extent,” which refers to the concept that the fiduciary role is not “all or nothing.” The roles and responsibilities are and can be allocated and defined. The starting point for this evaluation is the Plan document and any auxiliary agreements. Second, is the activity or conduct of the person or corporation involved and whether that activity or conduct falls within the scope of fiduciary conduct. The starting point for looking at activities and conduct is whether the person or entity is acting with discretionary authority or discretionary control over the Plan operation or administration, or assets. Any actions that involve discretionary authority or control will be fiduciary in nature.

Finally, with respect to investment advisory services, when there is investment advice delivered to a Plan for a fee, then there is also a fiduciary role established for the advisor. The mere movement of money on direction from a fiduciary from one account to another, or the act to undertake or complete an investment at the direction of a fiduciary is not a fiduciary act, even if there is a transaction fee. It is the delivery of investment advice for a fee that creates the fiduciary role in this regard. We will further discuss investment advice later in this article under The “3(21)” Non-Discretionary Fiduciary, Investment Advisors section.

The Functional Fiduciary – The Catch-All Under ERISA 3(21)

This section of ERISA also gives rise to the all-encompassing "functional fiduciary" role. The broad spectrum of any discretionary authority or control under ERISA 3(21) creates the catch-all fiduciary principal, defined by the courts as the functional fiduciary. The basic principal in this regard is that any person that engages in any discretionary authority or control over these aspects of a Plan is a fiduciary. This is regardless of whether there is an agreement, or whether the person intends to engage in this conduct or not. If you "function" as a discretionary fiduciary under ERISA, you are one.

The Named Fiduciary – The Highest Level Fiduciary

This critically important function is defined under ERISA as the "Named Fiduciary." Under ERISA Section 402, each Plan must have a Named Fiduciary. A great deal of time and effort is spent on understanding the other fiduciary roles and responsibilities, yet most Plan officials do not truly understand this specific and required role and how it may impact Plan operations, and related risks. By law, this is the fiduciary (through its authorized agents, as applicable) that all participants and beneficiaries can turn to regarding all of the fiduciary functions under a particular Plan. Ultimately, a participant can turn to the Named Fiduciary to determine who is the responsible fiduciary with respect to each aspect of the Plan.

What does the Named Fiduciary normally mean to the common 401(k) Plan?

The Named Fiduciary can appoint others to provide various levels of support, both fiduciary and non-fiduciary in nature. Delegation of responsibilities may also be undertaken in the Plan document itself, which is often recommended. The Named Fiduciary can delegate responsibilities to an administrator, to a Trustee, an investment advisor, an investment manager and other responsible fiduciaries. It is important to establish, when possible, that a company or corporate entity is given the role of the Named Fiduciary – as opposed to any individual or to some vague reference to some group of people or committee. The corporate form can provide certain protection from personal liability, but that corporate structure must be in place, in operation and maintained.

Regardless of the identity of the Named Fiduciary, the function and operation is critical. So, finding the right service provider can then make all of the difference in terms of exposure, service and comfort.

The best solution is for the Plan sponsor to create a structure for Plan administration, operation, investment management and custodial services that best serves the participants and beneficiaries and properly allocates

responsibility amongst the various service providers. The Named Fiduciary must be cognizant of any conflicts of interest and determine whether the service provider selected is contractually accepting of the role and responsibility, or running from it. For example, many companies and service providers offer "fiduciary services" or "fiduciary warranties" but in reality, when you read the fine-print, they offer nothing of value. Congruently, it is prudent for the Named Fiduciary to align itself with service providers of high-caliber and capability who are able to provide real value to the Plan and to alleviate fiduciary risk, not increase it. Sometimes this is accomplished, and other times not.

The Co-Fiduciary

Maybe the most misunderstood, misapplied and even ignored fiduciary role is the Co-Fiduciary. This relationship can be established with respect to any fiduciary role under a Plan.

The Co-Fiduciary is often talked about by investment professionals and other Plan advisors, in a haphazard and meaningless way. The Co-Fiduciary role can exist or be created intentionally by an agreement that calls for an allocation of responsibilities and roles, **or even unintentionally without an agreement**.
Often overlooked is the fact that Co-Fiduciary responsibility can arise unintentionally if there is knowing participation in a breach of duty, any failure to comply with obligations or enabling a breach of duty, or a failure to remedy a breach within the fiduciaries area of responsibility. The unintentional mechanisms for ascribing and creating Co-Fiduciary liability are not undertaken by design, but exists nevertheless by statute under ERISA.

By design, the Plan and Named Fiduciary can, by the Plan document or by agreement, assign Co-Fiduciary responsibility to certain persons or entities with respect to certain aspects of a Plan. Assets can be jointly managed. Various fiduciary roles can be allocated and jointly assumed by one lead fiduciary service provider as the "go-to" provider, or to a series of more than one fiduciary in a Co-Fiduciary relationship. Some service providers take on the entire fiduciary responsibility. Others share the responsibility through the Co-Fiduciary role. This can be advantageous in certain instances as well.

It is critically important for the Named Fiduciary and other responsible parties to understand these relationships and not allow Co-Fiduciary roles to fall unintended or unattended.

The Trustee – Limited Role of Expansive Role?

Most Plans have a Trustee, and the role of the Trustee is defined by ERISA as well. Under ERISA Section 403, unless certain exceptions apply, Plan assets must be held in Trust. Thus, the "Named Fiduciary" is to appoint a Trustee, which is the person or entity that has the "exclusive authority and discretion to manage and control the assets of the Plan." This is all subject to the appointment authority of the Named Fiduciary.

Of course, as we noted above, these roles are not all or nothing propositions. The statute specifically provides for exceptions to the Trustee role and permits the allocation of responsibilities of a Trustee to others. Most relevant to this discussion is the exception to the Trust requirement for insurance contracts or policies issued by an insurance company, or assets of an insurance company that are held by that company for the Plan. Such assets are not required to be held in Trust. Other limits on the role of the Trustee or delegation of some Trustee duties to others, can be provided for as well.

The Plan can provide that the Trustee is subject to the direction of a Named Fiduciary who is not a trustee. In that case, the Trustee must follow the direction of another in the performance of their duties.

Another exception is the specific authority delegated to one or more 3(38) Investment Managers to manage, acquire or dispose of assets (see 3(38) Inv. Mgr. section below), and if so, the 3(38) Investment Manager retains primary responsibility for the assets, and **the Trustee is "off-the-hook"** with respect to the management of the assets.
Another mechanism for limiting the role of the Trustee often found in 401(k) Plan arrangements is the role of the "Custodial Trustee." This is an instance where the obligations and responsibilities of the Trustee are contractually limited to custody and protection of assets. In this type of arrangement, the Trustee is not responsible at all for any Plan administration, investment management or Plan operations.

The key here is that the roles and responsibilities are allocated to others and that each role and responsibility is articulated in writing, and understood by all concerned. Plan sponsors should consider if their service providers create an appropriate structure that aligns well with the interests, experience and capabilities of the sponsor and staff. The Plan sponsor and the Named Fiduciary must fully understand the relationships and roles of everyone involved in the Plan as well as where their respective responsibility and liability begins and ends.

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The "ERISA 3(16)" Plan Administrator – Both Fiduciary and Non-Fiduciary in Nature

There are various fiduciary and non-fiduciary roles related to Plan administration and operation.

ERISA specifically identifies and defines the term "Administrator" not to be confused with a TPA, but really refers to a "Plan Administrator" under ERISA Section 3(16)(A). This Section defines the Administrator as the person or entity "so designated" under the Plan. If the Plan does not specify an "Administrator," the Plan sponsor commonly serves automatically in that role. But really, that is all that this section of ERISA provides. It does not create in the role of Administrator any fiduciary responsibility or liability.

To determine precisely what this role involves, the actions and responsibilities of the Administrator need to be evaluated. Certain functions of the Administrator will be fiduciary in nature, and others will not be of a fiduciary nature, but rather, will be non-fiduciary ministerial duties. The responsibility and liabilities related to this role are very different depending upon the exact nature of the Administrative tasks involved.

Starting with the non-fiduciary ministerial duties, in general, include:

- applying eligibility rules to participation or benefits and calculating benefits and crediting service;
- preparing employee communications;
- preparing drafts of government filings;
- maintaining records;
- collecting and/or applying contributions, accounting and reconciling data;
- processing approved claims and loans for distribution;
- orientation of participants and providing Plan information;
- preparing benefit statements; and
- making Plan administration recommendations.

By contrast to these ministerial duties, fiduciary functions involve the exercise of discretionary management and control over administration and/or assets of a Plan.

Examples of Administrative tasks involving the exercise of discretion and control include:

- the authorization of distributions or loans, or any plan transactions
- investment services for a fee provided by an administrative company
- investment monitoring services for a fee (see discussion below),
- any selection or monitoring of investments,
- the selection of certain Plan service providers, and
- actions to enforce or interpret the terms of the Plan, or decisions on claims for benefits or other Plan-related decisions.

When retaining an independent ERISA 3(16) Administrator, the Plan official should determine the precise scope and responsibility being taken on by that Administrator. Some duties will be fiduciary in nature and others are not! If the Plan terms or an agreement do not delegate certain responsibilities, then they are retained by Plan officials.

The "3(38)" Investment Manager Fiduciary

An ERISA Section 3(38) Investment Manager is a specifically defined role. When authority is delegated to one or more 3(38) Investment Managers to manage, acquire or dispose of assets the 3(38) Investment Manager retains primary responsibility for the assets, and **the Trustee is "off-the-hook"** with respect to the management of the assets. The Investment Manager is authorized and acknowledges in writing, allowing for someone other than the Named Fiduciary or Trustee, certain specific responsibility regarding the power with discretion to manage, acquire, or dispose of any asset of a Plan. This can be any person who maintains the requisite license to provide such services, including a Registered Investment Advisory ("RIA") business entity.
Most commonly, this role is with respect to investment management services, but this role can be more expansive and when it is, can prove very useful to the Plan and its sponsor.

This role comes with responsibility, and can provide a critical and helpful function for Plan officials and sponsors, because it allows the retention of certain control functions while allocating certain primary responsibility for investment, or other Plan management **to a third party fiduciary who is not only responsible, but liable.**

The "3(21)" Non-Discretionary Fiduciary, Investment Advisors

As stated above, the rendering of any investment advice for a fee, (whether the fee is direct or indirect), creates a specific investment advisor fiduciary role unlike the other fiduciary roles we have discussed requiring discretion. Importantly, this role does not involve the exercise of discretion and is not defined to include the exercise of discretion. Rather it is any investment advice given to a Plan and/or participants and beneficiaries that creates this specific fiduciary role. Notably, the mere investment advice fiduciary has a very limited fiduciary role and responsibility to the Plan. Without discretion, the investment advice fiduciary is a very specific and very limited responsibility.

It should be noted that a broker-dealer or its registered representative may be receiving commissions for providing recommendations incidental to the purchase or sale of securities, not for providing advice. Given this fact and circumstance, a broker will not be an investment advice fiduciary merely because it receives a commission to move assets based upon an instruction. **But Plan sponsors beware.** The act of providing recommendations can easily be turned into advice if:

- such person makes investment recommendations on a regular basis pursuant to a mutual agreement or understanding with the Plan, written or otherwise;
- that such services will serve as a primary basis for the Plan's investment decisions; and

- that such person will render individualized advice based on the particular needs of the Plan. The DOL has taken the position that "investment advice" may also include advice provided to a participant in a defined contribution Plan with participant-directed investments.

If the broker is paid any fee, on an asset basis or otherwise, while giving investment advice, this may then give rise to fiduciary status. Again, Plan officials should be very careful to evaluate the roles and responsibilities and who is being paid what money for what services. Ultimately, the lead fiduciaries for a Plan will be responsible!

This is a perfect example of why understanding the role and responsibility of all service providers is paramount for Plan officials.

The Participant "Fiduciary Adviser" – Participant Level Investment Advice

The Pension Protection Act 2006 created a new category of fiduciary providing an exemption to the prohibited transaction rules, expanding the universe of those eligible to provide investment advice to Plan participants and beneficiaries. The specifics of the investment advice regulations didn't become effective until December 27, 2011.

This category of fiduciary provides individualized participant investment advice that goes beyond general investment education. It provides specific recommendations to a participant for the management of their 401(k) account. A Plan sponsor is provided fiduciary liability protection from the investment advice given to participants and beneficiaries if properly contracted, rules are followed and monitored.

This role has certain limits and is subject to very specific prohibited transaction rules. These rules address the actual and potential conflicts of interest and methods and strategies for making sure that Participants are receiving the proper advice in a manner that avoids conflicts. If you support this role, you should be confident that these rules are being followed and you should understand them.

Certain rules must be followed governing the type of advice provided and the method of its delivery.

It is a fiduciary responsibility to ensure that the line between investment education and investment advice is not crossed by an attending advisor, unless the proper structure is in place. Most Plan fiduciaries are not aware of this, and permit advisors to cross these lines, thinking it is helpful. Sometimes it is, but such activity can create more liability for the Plan fiduciary and as such, permitting this line to be crossed does not justify allowing actions that can potentially involve conflicts in interest and prohibited transactions.

For those having a conflict of interest, the Pension Protection Act requires investment advice be delivered under an Eligible Investment Advice Arrangement (EIAA) by an adviser who must agree in writing to be "acting as a fiduciary of

the Plan in connection with the provision of the advice". This requirement differs greatly from the general definition of a fiduciary who acts as a fiduciary with respect to the entire Plan and not limited to only those assets to which advice is connected.

Some participant advice arrangements do not involve the Plan fiduciaries.

Plan participants can hire an advisor to manage their 401(k) account outside of any other relationship to the Plan. What the Plan sponsor must be sure to understand is whether the advisor, picked by the participant becomes a fiduciary to the Plan. This relates to whether or not the participant has given the advisor discretionary control over the participants account. A Plan sponsor has no obligation to the participant to provide any guidance or assessment of the advisors services, engaging in this type of relationship. A Plan sponsor is best to avoid any involvement in the arrangement including the authorization for such services to be paid out of the participants account. Maintaining a Chinese wall between the Plan and this type of arrangement maintains the Plan sponsors liability protection from the advice provided to the participant.

So what does this all mean for the Plan Sponsor and Officials? It is critically important to understand –

- Who fulfills the educational role and do any401(k) investment discussions go beyond education with any individual participant?
- Who has direct management access over the participant accounts and are there other unintended fiduciaries?
- If individual advice is being given, does it comply with the requirements and avoid conflict and prohibited transactions?
- What fiduciary protection is given by any individual advice model and respective provider?
- Are you exposed to any liability and do not intend to be?

It is important for the Plan Official and fiduciaries to carefully select and determine the role for individual advice and select the right provider who can offer real protection.

Limitations, Self-Direction and Monitoring

As stated above, the role and responsibility of the fiduciary is not mandated to be an all or nothing proposition. Thus, there are limits on the fiduciary role that must be managed and evaluated. The first limit is that certain sponsor related functions are not fiduciary functions. The right and responsibility to implement, amend or alter, terminate or merge a Plan, is not a fiduciary function, these are called "Settlors Acts." They are considered business decisions of the Plan Sponsor. Plan officials should be aware of this distinction, but the details of this distinction are beyond the scope of this

Article. It is best for the Plan officials to align themselves with a service provider, or counsel, to ensure that the lines between sponsor function and fiduciary function are understood and properly managed.

Additionally, in a Plan where employees self-direct their investments, the specific construct of the individual participant portfolios and the participant's investment results are not subject to the fiduciary rules, as long as the requirements of ERISA Section 404(c) are followed. These specifics are beyond the scope of this Article, but suffice it to say that the participant is not a fiduciary when the participant makes investment decisions.

Finally, most fiduciary roles that involve the appointment or allocation of responsibility to other fiduciaries require that the appointing fiduciary periodically monitor the appointed fiduciary conduct. This monitoring responsibility is part of the fiduciary role and is a critical component to ensuring that the fiduciary functions are being undertaken reasonably and properly. Plan officials can never shed 100% of their fiduciary responsibility or the potential for personal liability. It should, however, be properly established and managed.

This monitoring obligation supplies another reason to have the right structure and select the right fiduciaries and service providers for the Plan, to reduce and limit not only the responsibility and role, but also your risk.

Conclusion

The fiduciary role and responsibility is the most important and comes with it the most substantial liability.

The fiduciary lines of authority can be difficult to draw. As this Article points out, there are multiple roles and multiple types of fiduciary roles with respect to each retirement Plan. Identifying and contracting with the right service providers, understanding and knowing in great detail the roles and responsibilities and liabilities, and how to manage those roles, will provide a better functioning Plan with reduced overall liability and exposure to Plan officials and companies that sponsor these Plans.

In this regard, Plan officials should be able to ask and answer a number of important questions at the blink of an eye, such as:

- Who is the Named Fiduciary with respect to our Plan and could it be individuals with personal risk?
- Do we have a Trustee and if so, what are the limits of that role?
- Who are the other fiduciaries providing services to the Plan and is their role and responsibility well aligned with ours?
- Are our service providers equipped to evaluate and understand the continuous change that faces our Plan and arrangements?
- Are our fiduciaries subject to any conflicts of interest and if so, are they appropriate fiduciaries for us to retain?
- Are our fiduciary roles and responsibilities described and detailed in writing?

Evaluating and answering these important questions will permit the Plan officials and sponsor representatives to avoid direct attribution of risk and liability, and result in a safer Plan that better serves the Participant and Beneficiary contingencies.