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Delegation for Plan Sponsors (Part 3)

by W. Scott Simon | 06-04-09

This month I'll describe in some detail how it's possible to insulate the sponsor of a qualified retirement plan such as a 401(k) plan--the "sponsor" actually being represented collectively by real flesh and blood humans who serve as trustees and other named and functional fiduciaries of the plan--from virtually all day-to-day fiduciary investment risk as well as operational/administrative risk to which they would otherwise be subject in the act of sponsoring the plan.

Plan sponsors choosing this approach can avoid the legal landmines that are inherent in the current business model that they are forced to follow by most service providers in the retirement plan industry--a model in which these non-fiduciary product pushers are the inmates that run the asylum--and instead embrace a model in which professional fiduciaries fully conversant with the ins and outs of ERISA law and procedure are placed in charge of running the sponsor's plan as has been intended all along by the law of ERISA.

This approach centralizes authority and duties in one professional named fiduciary. Removing ERISA-defined fiduciary discretion in this way that would otherwise hang over the heads of, say, senior-level company executives and even junior-level folks in a company's human resources department prevents all of them from intentionally or inadvertently acting in a discretionary (i.e., fiduciary) role. This is critical because, under ERISA, discretion is the primary trigger of fiduciary responsibility and liability. That is, where there's no discretion, there's no responsibility. And where there's no responsibility, there's no risk or liability. Voilà! Ze problem is solved. Now let's see how to actually accomplish this.

Acceptance of Appointment as a Named Fiduciary

The sponsor of, say, a 401(k) plan interested in retaining a professional independent fiduciary to take over virtually all day-to-day fiduciary investment and operational/administrative duties attendant to its plan should look for a fiduciary that will accept appointment as a "named fiduciary" pursuant to ERISA section 402(a). DOL Advisory Opinion 2002-06A (issued July 3, 2002) states, in part: "Section 402(a) of ERISA provides that every employee benefit plan [e.g., a 401(k) plan] shall be established and maintained pursuant to a written instrument. This instrument must provide for one or more named fiduciaries who have authority to control and manage the operation and administration of the plan. The named fiduciaries may be either named in the plan instrument or chosen, through a procedure specified in the plan, by the plan sponsor." ERISA section 402(a) is further explained under ERISA sections 3(16) and 3(21). These two sections of ERISA define the two primary fiduciary roles within a qualified retirement plan.

ERISA section 3(16) defines the term "plan administrator." (The fiduciary duties of a plan's plan administrator shouldn't be confused with the non-fiduciary duties of a "third party administrator" servicing the plan.) The plan administrator is the fiduciary identified by the plan document that has the discretionary authority to manage the day-to-day affairs of a qualified retirement plan. The plan administrator can be an individual or the sponsor of the plan. In most plans, the plan administrator is the plan sponsor.

ERISA section 3(21) defines a fiduciary: an individual that exercises discretionary authority or control over plan management and disposition of assets, or has authority to render advice for money whether or not advice is actually given, or has discretionary authority or responsibility in the administration of a plan. An ERISA section 3(21) fiduciary could therefore be given total discretion over an entire plan, including those duties associated with that of ERISA section 3(16), even though a plan may have specifically named a person or organization to fill that role. An ERISA section 3(21) fiduciary, then, can be a "catch-all" with respect to fiduciary responsibility. There can be interplay or overlap between section 3(16) and section 3(21) responsibilities, but these two sections of ERISA are

clear enough to cover the basics with respect to day-to-day fiduciary duty.

It's important to note that some in the retirement plan industry have created marketing gimmicks to capitalize on the cache and power of being an ERISA section 3(21) fiduciary. Upon closer examination, though, the "discretion" that's actually accepted for any fiduciary responsibilities in this kind of marketing-driven environment is essentially zero, in my opinion. Such entities create the appearance of fiduciary stature, but in fact they turn out to be fiduciary nothings. One way to recognize such pretenders from a real named independent fiduciary under ERISA section 3(21) that has absolute responsibility to operate a qualified retirement plan through delegation from the plan sponsor is to be on the lookout for the term "co-fiduciary." (My [four-part series](#) three years ago documented this.) An honest-to-goodness named independent fiduciary would never use the term "co-fiduciary;" the term has no legal meaning in ERISA.

Acceptance of Appointment as the Plan Trustee

It's usually the board of directors of a company that sponsors a retirement plan that appoints a named fiduciary under ERISA section 402(a). The named fiduciary can also accept appointment as the "plan trustee" pursuant to ERISA section 403(a). DOL Advisory Opinion 2002-06A states, in part: "Section 403(a) of ERISA provides, in part, that all assets of an employee benefit plan must be held in trust by one or more trustees. The trustee(s) must have exclusive authority and discretion to manage and control such assets ... [except] ... when the plan expressly provides that the trustee(s) are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees are subject to proper directions made in accordance with the terms of the plan and not contrary to ERISA ..."

Language in plan documents doesn't ordinarily limit the power of the plan trustee deemed necessary to fulfill its generally contemplated duties. If there are no specific limitations or restrictions placed upon a trustee, the named independent fiduciary can also assume the role of plan trustee. If a plan document limits the power of the plan trustee, though, the named independent fiduciary cannot serve in both capacities at the same time. In that case, the named independent fiduciary will exercise full discretion and also provide directions to the plan trustee; hence, the term "directed trustee." In other words, where an entity accepts appointment as a full-scope, named independent ERISA section 3(21) fiduciary, the plan trustee must "take orders" from the named fiduciary except in cases where the named fiduciary also assumes the role of the plan trustee.

Acceptance of Appointment as the Plan Administrator

The named independent fiduciary can, in addition, accept appointment as the plan administrator of a retirement plan pursuant to ERISA section 3(16). A common misunderstanding is that the fiduciary duties of an ERISA section 3(16) plan administrator cannot be delegated. This is not true. Federal district courts delegate such duties all the time, including, for example, when they appoint named fiduciaries in cases where the court decides to cut off the power of a plan sponsor to appoint other plan fiduciaries. (The fiduciary duties of a plan administrator, as noted, shouldn't be confused with the non-fiduciary duties of a third party administrator servicing the plan.)

Acceptance of Appointment as an Investment Manager

A plan sponsor can appoint one independent fiduciary to play the role of plan trustee pursuant to ERISA section 403(a), and a separate investment fiduciary as an ERISA section 3(38)-defined "investment manager" pursuant to ERISA section 405 (as long as such separate investment fiduciary has not already been appointed as the ERISA section 3(21) fiduciary). Such an investment manager is solely responsible for prudently selecting and monitoring the investment options offered in, say, a 401(k) plan. (Prudent Investor Advisors, the registered investment advisory firm operated by my partners and I, accepts appointment as an ERISA section 3(38) investment manager directly from a plan sponsor, but the focus of this series involves a named ERISA section 3(21) independent fiduciary accepting such appointment from a plan sponsor, and then delegating that duty to an ERISA section 3(38) investment manager.)

DOL Advisory Opinion 2002-06A states, in part: "Section 405(c)(1) of ERISA provides, in part, that the named fiduciaries may designate persons other than named fiduciaries to carry out fiduciary responsibilities (other than trustee responsibilities) under the plan. Section 405(c)(3) of ERISA

defines "trustee responsibility" to mean any responsibility provided in the plan's trust instrument to manage or control the assets of the plan, other than a power under the trust instrument of a named fiduciary to appoint an investment manager in accordance with section 402(c)(3)." (Translation from lawyer-speak to plain English: A full-scope, named independent ERISA section 3(21) fiduciary has the authority to appoint an independent ERISA section 3(38) investment fiduciary. If such appointment occurs, it is the section 3(21) fiduciary that has responsibility to monitor the section 3(38) fiduciary and to renew the section 3(38) fiduciary assignment from time to time. In this kind of situation, the plan sponsor, in turn, always has the same obligation to monitor the section 3(21) fiduciary except in one specific scenario that's beyond the scope of this series.)

Acceptance of Administrative/Operational Duties

Provisions in ERISA have a built-in mechanism that allows a plan sponsor that is incapable, unwilling or unable to fulfill fiduciary functions to outsource them. As long as the plan sponsor has properly delegated the authority to the recipient of the delegation, conducted due diligence in a way to achieve a prudent and informed outsourcing decision and has put in place a prudent on-going monitoring process to oversee the recipient of the delegation, outsourcing of fiduciary duties is permitted under ERISA.

Delegation of such duties could also include administrative/operational responsibilities that are non-fiduciary in nature. For example, while payroll processing, processing of newly hired employees and terminations of employees are functions typically handled by a company's human resources department (and are not functions related directly to a company's retirement plan), responsibility for their fulfillment can nonetheless be delegated to a professional named fiduciary by the plan sponsor. So even in cases where discretion and judgment are not required, a plan sponsor still has the power to delegate responsibility, whether it be fiduciary in nature or only ministerial (i.e., non-fiduciary in nature).

Tying It All Together: Acceptance of Appointments and Then Delegation

The acceptance by a professional named independent fiduciary of the duties prescribed by ERISA sections 402(a), 403(a), 3(38), 3(16) and 3(21) with respect to a qualified retirement plan such as a 401(k) plan is the gold standard of fiduciary responsibility, since it encompasses all other fiduciary duties--but only if so desired by the plan sponsor making such appointments. This can insulate the plan sponsor from virtually all day-to-day fiduciary investment risk as well as operational/administrative risk in sponsoring a plan.

Once a named independent fiduciary has accepted appointment of all the foregoing duties, it then has the right and the power to hire (and fire) all other professionals such as investment advisors, custodians, third party administrators and other service providers to the plan. This, after all, is the entire point of taking the approach set forth in this series. Delegation of these duties to different people or organizations is advantageous for purposes of efficiency and to encourage favorable outcomes for plan participants. Even more important, such delegation transforms a high risk scenario to a low risk one by appointing independent entities with specialized expertise to perform these functions.

When a named independent fiduciary accepts appointment of these duties and then delegates them to professional plan providers with specialized expertise, a plan sponsor achieves yet another critical advantage: the named fiduciary itself has a significant fiduciary obligation to monitor such professionals since the liability of the named fiduciary is tied directly to how well (or how poorly) these professionals carry out their duties. In short, the named fiduciary literally has its own skin in the game. This is powerful motivation to help ensure that incentives are aligned in a rational and prudent way. Such monitoring by a named independent fiduciary also relieves the employees of a plan sponsor from the responsibility of having to monitor and evaluate themselves.

A plan sponsor with an interest in further exploring how they can be insulated from virtually all day-to-day fiduciary investment risk as well as operational/administrative risk in sponsoring a plan may wish to consult with an ERISA attorney. Many ERISA attorneys, in addition, know how to locate--or may already know--named independent fiduciaries that have the experience and expertise to perform at the high level discussed here.

In next month's column, I'll discuss two recent, on-going lawsuits, one involving a very large publicly traded company and one involving a relatively small law firm and show how they could have avoided the costs (and needless time and heartbreak expended) associated with the litigation by simply retaining a professional named independent fiduciary. I'll also explain why very few plan sponsors have never even heard of the kind of significant risk mitigation described in this series--much less understand how they can benefit enormously from it.

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Simon provides services as a consultant and expert witness on fiduciary issues in litigation and arbitrations. He is a member of the State Bar of California, a Certified Financial Planner, and an Accredited Investment Fiduciary Analyst. Simon's certification as an AIFA qualifies him to conduct independent fiduciary reviews for those concerned about their responsibilities investing the assets of endowments and foundations, ERISA retirement plans, private family trusts, public employee retirement plans as well as high net worth individuals.

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