

Every now and then “industry experts” write and distribute confusing or misguided information that unintentionally helps professional fiduciaries. Upset and confused clients turn to us to “unscramble industry messages.”

Plan sponsors reach out to independent fiduciaries for help. The nature of our business is always at the complexity redline; we’re often asked to do what seems impossible. Plan sponsors want and need to rely

on someone who is legally accountable to plan participants – someone who will establish a fiduciary relationship with them – and run a profitable business at the same time.

When we sort through the confusion created by “industry experts,” we will solidify our relationships of trust with plan sponsors and expand our influence. Like the “breakfast-only” restaurant down the block that specializes in one area of true expertise, we stand to reap the benefits from the frustration and confusion generated by our well-intentioned colleagues.

Fiduciary Clarity

The various fiduciary roles for qualified retirement plans is spelled out in the Employee Retirement Income Security Act

(ERISA). ERISA identifies six general categories of fiduciaries:

1. Named Fiduciary
2. Plan Administrator
3. Trustee
4. Investment Manager
5. Investment Advisor
6. Others that owe a duty of loyalty or act with discretion or authority “to any extent.”

1. The Named Fiduciary

A qualified retirement plan, as described in section 401(a) of the Internal Revenue Code (IRS), is one that meets the definition of a pension benefit or employee benefit plan under ERISA sections 3(2) and 3(3), respectively. Such a plan, most often a 401(k) plan established for a business, comes into being once plan documents have been drafted and signed.

A responsible party must be named in the plan documents with the duty and the power under ERISA to, in effect, “run” the plan. That party is called the “Named Fiduciary” and it is described in ERISA section 402(a). The Named Fiduciary, which can be an employee of the plan sponsor or even an independent party, has the duty to control, manage and administer the plan, according to ERISA section 402(a)(1). The Named Fiduciary is the primary decision maker in making a qualified retirement plan work; it is the person with ultimate day-to-day responsibility for that.

The Named Fiduciary is always considered a fiduciary within the meaning of ERISA section 3(21). That’s why I have referred to such a

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fiduciary as a “full scope” 3(21) fiduciary (see *Sears Roebuck & Co.*, 2004 N.D. Ill. Mar 3 2004). This is merely one descriptive term for such a fiduciary but other terms that are used such as “full service” trustee or “discretionary” trustee could serve just as well (see page 7 of “Evaluation of the Full Service Discretionary Trustee Services Offered by The American National Bank of Texas Wealth Management Group Trust Division,” July 2007, by Bruce Ashton and Debra Davis of the law firm of Reish Luftman Reicher and Cohen, now Reish & Reicher). Whatever the descriptive term one chooses to ascribe to the primary fiduciary decision maker, that role will always “covers the full spectrum of administrative and investment duties of fiduciaries under ERISA.” In short, the full scope 3(21) fiduciary is THE Named Fiduciary; put another way, the Named Fiduciary is THE full scope 3(21) fiduciary.

An investment advisor is not, and never will be, the full scope 3(21) fiduciary unless the advisor’s name actually appears in plan documents as the Named Fiduciary with authority to hire, monitor, fire and replace service providers and other fiduciaries.

2. The Plan Administrator

The “Plan Administrator” of a qualified retirement plan is defined in section 3(16) of ERISA. The Plan Administrator should not be confused with a “Pension Administrator” or a “Third Party Administrator.”

The Plan Administrator has the following primary responsibilities:

- Ensures all filings with the federal government (form 5500, etc.) are timely made;
- Makes important disclosures to plan participants;
- Hires plan service providers if no other fiduciary has that responsibility; and
- Fulfills other responsibilities as set forth in plan documents.

ERISA sections 101, 102 and 103 describe the specific fiduciary responsibilities and duties of the Plan Administrator. As a practical matter, the plan sponsor will normally reserve these functions of the

Plan Administrator for itself. But in some cases, a plan sponsor may appoint an independent fiduciary to serve as the ERISA section 3(16) Plan Administrator. Sometimes a federal court may appoint an independent person to serve as the Plan Administrator of a plan. In any event, the responsibilities and duties of the Plan Administrator are fiduciary in nature.

3. The Trustee

ERISA sections 403(a) and 403(b) describe the duties of the “Trustee.” The Trustee is a person or group of persons recognized as having exclusive authority and discretion over the management and control of plan assets. Unlike the full scope powers of the Named Fiduciary, the Trustee possesses a specific scope of delegated responsibility. (People sometimes refer mistakenly to a custodian as the “Trustee,” but in the context of ERISA, the Trustee is the person that has responsibility for managing trust assets.)

The Trustee is accountable to, and monitored by, the Named Fiduciary. A Trustee can be a “directed Trustee,” meaning that it must take directions from a fiduciary with a higher level of authority. For example, the Named Fiduciary (i.e., the full scope/full service/discretionary/whatever one wants to call the Named 3(21) fiduciary) could direct the Trustee to perform certain functions, or it could even replace the Trustee with another.

It is also possible for the full scope 3(21) fiduciary to appoint an ERISA section 3(38)-defined “Investment Manager” that will provide directions to the Trustee. In the absence of an ERISA section 3(38) fiduciary, the Trustee will generally retain its exclusive authority and discretion over plan assets until revoked by the Named Fiduciary. It is even possible for the Named Fiduciary to retain Trustee responsibilities, thereby serving as both Named Fiduciary and Trustee.

4. The 3(38) Investment Manager

ERISA section 3(38) defines the “Investment Manager” as a fiduciary with full discretionary powers for selecting, monitoring and (if necessary)

replacing the investment options (i.e., trust assets) in a qualified retirement plan. When appointed by an authorized fiduciary (e.g., the Named Fiduciary), the 3(38) takes an ascendant role over the Trustee. The Trustee then becomes "directed" by the ERISA section 3(38) Investment Manager. The 3(38) fiduciary is appointed, as noted, and monitored by the Named Fiduciary (or the full scope 3(21) fiduciary).

The 3(38) Investment Manager may hire and monitor other service providers relevant to its scope of responsibility. For example, the 3(38) will monitor fund managers, custodians and others. In such cases, it has the power and the duty to replace such service providers as it deems necessary and appropriate in its sole discretion.

The 3(38) has the responsibility to make sure that the fees charged by service providers are reasonable. The 3(38) fiduciary must also ensure that "Prudence" exists within the plan management environment, that investment meetings are properly executed and managed, that responsibility is properly delegated as appropriate, and that measurements are implemented to verify that the objectives of the plan's portfolios are being met.

5. The Investment Advisor

The investment advisor is not a term ERISA defines in the same manner as the aforementioned fiduciaries. An investment advisor to a qualified retirement plan may not, and usually does not have discretion over plan assets per se, but may exercise a certain level of influence and control over the operation of the plan. In other words, the investment advisor may not have explicit discretionary authority over the operation of a plan, but may exercise effective discretion through its influence upon others. At a minimum, the investment advisor must meet a fiduciary standard of care and, like all fiduciaries under ERISA, bears a duty of loyalty to the plan and plan participants which requires the advisor to:

- Put the plan participants' best interests first;
- Act with prudence; that is, with the skill, care, diligence and good judgment of a professional;
- Not mislead plan sponsors or plan participants,

but provide conspicuous, full and fair disclosure of all material facts;

- Avoid conflicts of interest; and
- Fully disclose and fairly manage, in the plan participants' favor, unavoidable conflicts.

The investment advisor to a plan is always a limited scope section 3(21) fiduciary except when it is appointed as an ERISA section 3(38) Investment Manager. For example, the investment advisor does not replace the Trustee, or act with unilateral discretion with respect to assets in a portfolio. It does not have the authority to establish its own fees or the fees paid to other fiduciaries. The investment advisor can only propose fees that may (or may not) be approved by a higher authority in accordance with plan documents. Nor does it have responsibility to retain and pay legal counsel, auditors, actuaries or other service providers on behalf of the plan generally. Those responsibilities normally are retained by the Named Fiduciary or Plan Administrator. If the investment advisor does not act in a 3(38) capacity, it will always be a limited scope 3(21).

The primary difference between a limited scope 3(21) investment advisor fiduciary and a 3(38) investment manager fiduciary is true "discretion." Investment advisors give advice, but the recipient may choose to accept or reject it. Therefore, the role and of a 3(21) investment advisor in the fiduciary context is truly limited. On the other hand, a 3(38), or Trustee in absence of a 3(38), possess true authority to make decisions at their discretion and prudent judgment. The difference between an investment advisor and a 3(38) can be described as the difference between someone in the back seat giving directions to the driver of a car (investment advisor) and a person (3(38)) who has the keys and is actually driving the car. In my experience, the Named Fiduciary wants someone to drive the car and be accountable for getting the passengers to their destination safely and efficiently. It's easy to obtain proof that plan sponsors want an investment professional that is legally accountable to them and plan participants for decisions made. It's what plan sponsors want. Just ask them.

6. Other Fiduciaries

Other fiduciaries include members of committees that could be appointed by the board of directors of the plan sponsor or the Named Fiduciary as well as others that may be acting in some fiduciary capacity under ERISA due to their actions. Although rare in practice, committee members may collectively serve as the Named Fiduciary and/or the Trustee. More commonly, however, committee members serve as a council, and report to the Named Fiduciary and Trustee on a regular basis. The investment advisor to a plan may participate as a member of a committee. The ERISA section 3(38) fiduciary may attend committee meetings, but a committee cannot dictate decisions to the 3(38).

A committee may be charged with monitoring other fiduciaries such as the investment advisor, the 3(38) fiduciary, the Trustee or even the Named Fiduciary. Monitoring a fiduciary with full discretionary authority, however, does not give the committee discretionary authority greater than that of the Named Fiduciary. Rather, monitoring is simply a prudent way to hold all fiduciaries accountable, regardless of the scope of their authority and discretion.

Conclusion

Expert professional independent fiduciaries understand how all of these fiduciary responsibilities work together on a day-to-day

basis. After all, that is why plan sponsors use them. They are fiduciary experts and do more than talk about the concepts of fiduciary responsibility; they live it each and every day in order to deliver its benefits to plan sponsors and plan participants. From many years of serving as an Independent Named Fiduciary, I can attest that the best possible result for both is to appoint a full scope ERISA section 3(21) fiduciary (i.e., the Named Fiduciary) which, in turn, appoints an ERISA section 3(38) fiduciary. This structure enables professional fiduciaries to take appropriate action when necessary and lower a plan's cost structure below that of the prevailing market. It also gives plan sponsors a professional third-party to be held accountable for the prudent management of a plan. Appointing a limited scope 3(21) investment advisor may, however, adequately serve the interests of plan sponsor and plan participants in some cases.

The fiduciary profession is an honorable and rewarding one. The roles and responsibilities undertaken by every fiduciary are important and valuable. Yet their true value must be conveyed accurately in order to (a) fulfill statutory requirements prudently and (b) avoid creating frustration and confusion that comes from scrambled fiduciary messages.

The following diagram may help communicate the proper fiduciary meanings and roles.



