The Three "3s"

The Differences Between 3(16), 3(21) and 3(38) Fiduciary Status

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What is a fiduciary? This is a question a lot of plan sponsors are uncertain about. In fact, according to a JP Morgan survey, 43% of company fiduciaries don't think they are fiduciaries. That's right. You can be a fiduciary for your retirement plan without knowing it. Often because there's confusion about how exactly a fiduciary is defined.

A fiduciary is a person or organization that owes to another the duties of good faith and trust. A person in this role is bound ethically to act in the other's best interest. Plan sponsors of retirement plans can pass on certain fiduciary responsibilities to service providers. This can be done as 3(16), 3(21), or 3(38) fiduciaries. Because it is one of the highest legal duties of one person to another, it is important for a plan sponsor to know and understand the differences when hiring a fiduciary.

3(16), 3(21), and 3(38) all refer to sections of the Employee Retirement Income Security Act (ERISA). ERISA is the law that describes the rules and regulations that come with the fiduciary title. Both plan sponsors and hired advisers are impacted by this law. The adviser fiduciary is, in many cases, willing to be held accountable along with the plan sponsor if litigation occurs, but they are generally not relieving the sponsor of any potential liability. To understand the difference between each fiduciary designation, let's consider them one by one.

3(16) Fiduciary ("Plan Administrator")

ERISA specifically identifies and defines the term "Administrator" not to be confused with a third-party administrator (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.

<u>Non-fiduciary</u> 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.

<u>Fiduciary</u> 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.

3(21) Fiduciary ("Investment Adviser")

The rendering of any investment advice for a fee, (whether the fee is direct or indirect), creates a specific investment advisor fiduciary role unlike other fiduciary roles requiring discretion. Importantly, this role is nondiscretionary 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. **The plan sponsor, designated committee or plan participant retains final decision-making authority.**

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;
- Such services will serve as a primary basis for the plan's investment decisions; and
- 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.

3(38) Fiduciary ("Investment Manager")

An ERISA Section 3(38) Investment Manager is a specifically defined role. The Investment Manager is authorized and acknowledges in writing, allowing for someone other than the Named Fiduciary or Trustee, certain specific responsibilities 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.

The difference between this designation and the 3(21) is that a 3(38) does have discretionary control over the plan's assets. **The fiduciary investment manager does not need the plan sponsor's permission to make changes to the retirement plan investments if serving in a 3(38) capacity**. A 3(38) manager has a fiduciary duty to prudently manage the plan's assets. This includes selecting, monitoring, and replacing investments for the plan.

The 3(38) section of ERISA states specific rules for this type of adviser. It requires written confirmation that the investment manager understands their fiduciary delegation and states that the 3(38) fiduciary is the only one responsible for the selection, monitoring, and replacement of the plan's investment options.

Only a bank, insurance company, or Registered Investment Adviser (RIA) can be named as a 3(38) fiduciary. This should not be confused with a plan adviser. Investment managers, as defined by ERISA, have legally defined discretion. If a Plan Sponsor hires a 3(38) fiduciary, they are giving up the discretionary authority to accept or reject the advice provided.

Obligation to Monitor

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. 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.

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.

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 the risk.

Conclusion

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

The fiduciary lines of authority can be difficult to draw. As we have pointed out in this article, 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, 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 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.

Sources: J.P. Morgan 2017 Defined Contribution Plan Sponsor Survey; Employee Retirement Income Security Act Section 3; 401(k)helpcenter.com