



Delegating Fiduciary Risk and Responsibility

The significance of being a fiduciary has been given much attention recently, especially with the DOL's proposed changes to the definition of fiduciary. With this heightened awareness, many plan sponsors are seeking to outsource these duties and associated risks. Because the selection and subsequent monitoring of service providers is a fiduciary duty itself, plan sponsors can never entirely delegate their fiduciary responsibilities. However, plan sponsors may delegate certain fiduciary duties to service providers, usually as a 3(16), 3(21) or 3(38) fiduciary.

Scope of Fiduciary Roles, Risks & Responsibilities

The delegation of fiduciary duties generally involves the delegation of discretionary authority or control over the management of the plan or its assets. Risk and responsibility follow discretion, so it is important to understand how much discretion is being delegated. Figure 1 illustrates the shift in risk and liability in relation to the amount of discretionary authority delegated. The actual scope of discretionary authority and the risk and liability that follow will vary depending on the terms of the plan and/or the service agreement(s) between the plan and any third-party service providers to whom these fiduciary responsibilities are delegated. Although plan sponsors can delegate certain fiduciary responsibilities, it is important to understand what risks and responsibilities remain after such delegation occurs.

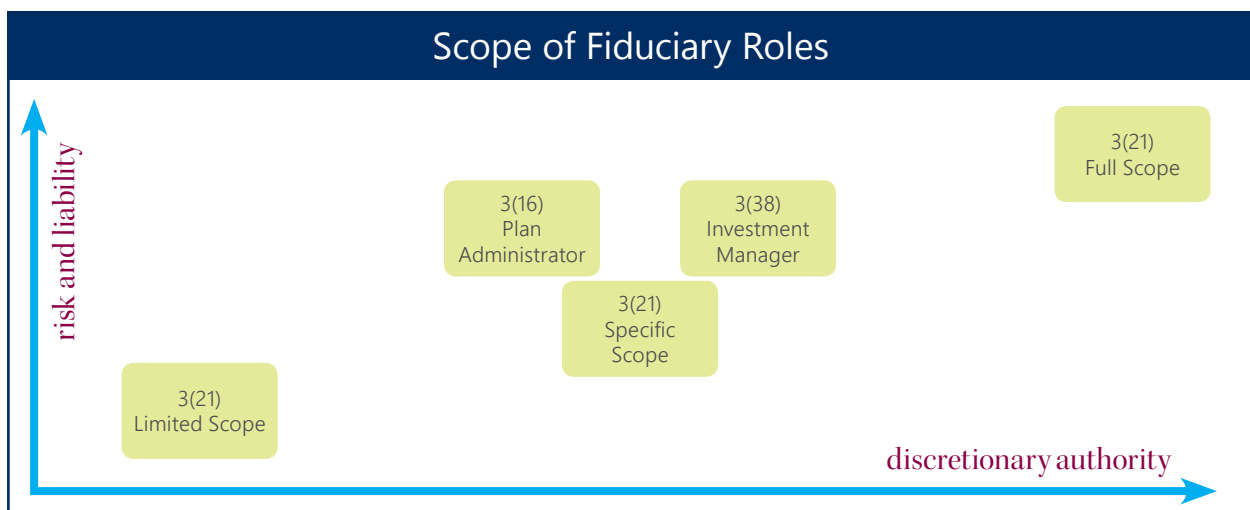


Figure 1: As the level of discretion that is delegated increases, risk and liability follow.

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Fiduciary Roles

Generally, plan sponsors can delegate certain fiduciary responsibilities to providers serving as a 3(16), 3(21) or 3(38) ERISA fiduciary.

3(16)

ERISA sets out specific fiduciary duties required for the plan administrator, and Section 3(16) defines who may serve in this role. Unless the plan document expressly provides otherwise, the plan sponsor is considered the plan administrator. Most plan sponsors choose to serve in this role; however, a recent trend is to hire an independent 3(16) fiduciary to be named as the plan administrator. In that case, the independent 3(16) fiduciary assumes the responsibility. A 3(16) fiduciary should not be confused with a third-party administrator (TPA). The primary difference is the level of discretionary control over the administration of the plan. With a TPA, the plan sponsor delegates some of its administrative duties, but it retains discretionary control; whereas with an independent 3(16) fiduciary, the plan sponsor delegates both its duties and discretionary control.

3(21)

ERISA Section 3(21) fiduciaries include individuals with discretionary authority or control over the plan or the plan's assets, as well as their appointees. Generally, this is a paid service provider who gives investment recommendations but does not have discretionary authority to execute investment decisions. It may also include delegation of discretionary plan administration responsibilities. The amount of discretion and associated risk and responsibility delegated to 3(21) fiduciaries varies by the terms of the plan and/or appointment. To address this, 3(21) fiduciaries are often referred to as full, specific or limited scope fiduciaries. These categories are not formally defined, which has led to discrepancies in terminology. Plan sponsors must ensure they understand the scope of any fiduciary delegation agreement and not rely solely on the terminology.

- **Full scope 3(21):** Full discretionary authority over the plan. Generally this is the fiduciary named in plan documents as required under ERISA 402(a) who typically provides investment recommendations, as well as discretion over plan administration. They have the most discretion and, consequently, the most risk and responsibility.

- **Specific scope 3(21):** Duty of loyalty in connection with a specific fiduciary assignment. Generally, this is a paid service provider who assumes discretion over a specific aspect of the plan, such as providing investment recommendations, but does not assume full discretionary authority.
- **Limited scope 3(21):** Fundamental duty of loyalty, but no specific fiduciary assignment. Generally occurs when individuals are not named or appointed fiduciaries, but they become such as a result of engaging in certain fiduciary activities. The duty of loyalty is limited to the scope of the fiduciary activity in which the individual engaged.

3(38)

Plan sponsors can delegate fiduciary responsibilities relating to the investment of plan assets to an independent investment manager. Section 3(38) sets strict requirements on who can qualify and requires that the investment manager acknowledge and agree to the fiduciary delegation in writing, and be solely responsible for the selection, monitoring, and replacement of the plan's investment options. A 3(38) fiduciary must be a bank, an insurance company or an RIA subject to the Investment Advisers Act of 1940. Section 3(38) investment managers should not be confused with plan advisors. Investment managers have legally defined discretion under ERISA, which gives them the ability to make decisions regarding investment options. Conversely, plan advisors are hired to provide recommendations and advice regarding investment options, but the plan sponsor has the discretionary authority to accept or reject the advice. Plan sponsors often choose to appoint both an investment manager and plan advisor.

Conclusion

Similar to Figure 1, actual fiduciary roles and responsibilities may vary depending on the specific terms of the plan and applicable service agreements. Further, it is important to note that although plan sponsors can delegate certain fiduciary responsibilities, they can never entirely delegate their fiduciary duties because plan sponsors have a duty to prudently select and monitor the plan's service providers. This duty cannot be delegated or waived.

