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RISK MANAGEMENT SYSTEM

What Type of Fiduciary Are You?



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Fiduciary services continue to be in high demand by retirement plan sponsors that lack the experience necessary to fulfill their fiduciary responsibilities as a prudent expert. A plan sponsor's decision to retain the services of a fiduciary advisor or any service provider is a discretionary fiduciary decision. Fiduciary decisions must be made with care, skill, prudence, and diligence. Documenting a fiduciary decision is a course of action that supports a claim of prudence. Based upon case law and Department of Labor ("DOL") publications, "best practices" indicate the documentation process should involve a request for proposal ("RFP") that is customized to the plan's specific needs. Due to the important role a fiduciary advisor plays in the success of the plan, the RFP should include a background check along with a detailed analysis of the advisor's experience, skills and knowledge. A plan sponsor fiduciary can ill-afford to retain an unqualified advisor, which is easy to do considering the unreasonably low qualification threshold established by the Securities & Exchange Commission ("SEC"), State Securities Departments and the Financial Industry Regulatory Authority ("FINRA") to license or register an advisor.

The need to conduct a formal assessment of an advisor's qualifications cannot be over-emphasized in light of the high demand for fiduciary expertise in today's retirement plan market place. With the effective date of plan level fee disclosure now past, plan sponsors should have in their possession information that will enable them to determine if the fees are reasonable, if conflicts exist and if the disclosures are complete. Unfortunately, few plan sponsors have in-house personnel with the expertise necessary to properly engage in the assessment anticipated by the DOL or articulated in the regulation. As a result, the demand for retaining external qualified fiduciary services is now at a fever pitch.

In response to the increasing demand for qualified fiduciary advisor services, the industry is experiencing an increasing number of advisors offering and promoting fiduciary services that were not offering those services in the past. Of course, that does not mean that every advisor who did not offer fiduciary services in the past is not capable of delivering competent fiduciary services today. Many advisors have functioned in a fiduciary role for years but have either refused or have been prohibited from acknowledging their fiduciary status due to compliance restrictions that have now been lifted. On the other hand, increasing demand and competition are convincing many advisors to assume a fiduciary role they are not qualified to hold, thus, making the process to evaluate advisor qualifications essential.

Although there are many types of fiduciary roles, most advisors that offer fiduciary services will either lay claim to skills of a fiduciary advisor as defined in ERISA § 3(21)(A)(ii) or an investment manager as that term is defined in ERISA § 3(38). While these two sections of ERISA provide distinct definitions, it is important to remember that all § 3(38)s are § 3(21)s but not all § 3(21)s are § 3(38)s. This means that there are some § 3(21) fiduciary roles that have authority that is equal to, less than or greater than a

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§ 3(38). These differences are important to understand in order to mitigate fiduciary risk, select the advisor with the skill set needed to assist in the prudent operation of the plan and adhere to ERISA's fiduciary standard of care.

ERISA Fiduciary Standard of Care

Understanding each fiduciary's role is necessary to adhere to ERISA's "fiduciary standard of care," the highest known to law. The fiduciary standard of care is outlined in ERISA § 405 and it imposes on each fiduciary the obligation to hold all other fiduciaries accountable for their actions. Under ERISA § 405 a fiduciary cannot knowingly participant in, conceal, enable or ignore a fiduciary breach. Thus, a fiduciary that is knowledgeable of another fiduciary's breach must take action to remedy the breach. However, if an advisor does not understand the different fiduciary roles and the interplay between these roles, the advisor is most likely unable to perform their fiduciary obligations in a comprehensive manner including holding other fiduciaries accountable. Of course, an advisor that fails to embrace the fiduciary standard of care is not only personally liable for their own actions, but also for the known breaches of other fiduciaries and possibly for fiduciary breaches they should have known about but failed to intervene and remedy.

Offering Fiduciary Education Implies Expertise

Advisors that offer fiduciary advice services under ERISA § 3(21) or investment manager services under ERISA § 3(38) are expected to be intimately familiar with their own fiduciary responsibilities but equally familiar with the fiduciary roles held by other persons.[1] In fact, most advisors (with few exceptions) promote their ability to educate the plan sponsor and their in-house fiduciaries i.e., the retirement or investment committee, on their fiduciary obligations. To offer fiduciary education implies the advisor is intimately familiar with the different fiduciary roles and the fiduciary standard of care; otherwise, the advisor is misrepresenting[2] their expertise. Misrepresentation could be grounds for a claim of fiduciary breach, payment of unreasonable fees for a service that does not exist or monetary damages tied to the advisor's recommendations.

Functional or Formal Fiduciary Appointment

An advisor's fiduciary status is determined by either formal appointment or their actions. An advisor that is determined to be a fiduciary by their actions is often referred to as a "functional fiduciary." A functional fiduciary is no less liable for their fiduciary conduct than a formally appointed fiduciary. A formally appointed fiduciary is typically appointed to a specific role, which is often memorialized in the plan document or a formal contract.

Key Point: *An Advisor can function as a fiduciary with or without a formal appointment.*

Charting Fiduciary Roles

The chart below provides a high level overview of the different types of fiduciary roles that a person can hold. Although a person can hold multiple roles, advisors typically serve as either an investment advisor or as an investment manager. Both fiduciary advisor and investment manager will be the focus of this analysis; however, there is a small segment of advisors accepting other fiduciary roles e.g., Plan Administrator and Named Fiduciary services. For a description of these fiduciary roles see *"The Impact of New Required Reporting Requirements"* *http://www.fraplantools.com/uploads/Technical%20Release%20on%20Schedule%20C%20Code%20Definitions.pdf*

[1] The term "person" means an individual, partnership, joint venture, corporation, mutual company, joint-stock company, trust, estate, unincorporated organization, association, or employee organization. ERISA § 3(9)

[2] "Misrepresentations and omissions [are] breaches of ... fiduciary obligations. Lying is inconsistent with the duty of loyalty owed by all fiduciaries." *Peoria Union Stock Yards Co. Ret. Plan v. Penn Mut. Life Ins. Co.*, 698 F.2d 320, 326 (7th Cir. 1983)

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ERISA	§ 3(21)(A)(i)	§ 3(21)(A)(ii)	§ 3(21)(A)(iii)
Definition	Discretionary authority or control over plan management and assets	Authority or responsibility to render investment advice for a fee	Discretionary authority or responsibility over plan administration
Parties	**Formal Appointment** • 402(a) Named Fiduciary • 403(a) Discretionary Trustee • 405(c)(1) Fiduciary Appointee • 3(38) Investment Manager	**Formal Appointment** • 40 Act RIA/IAR • 408(g) Participant advice	**Formal Appointment** • 402(a) Named Fiduciary • 403(a) Directed Trustee • 405(c)(1) Fiduciary Appointee • 3(16) Plan Administrator
	Functional • Any individual or entity • 3(17) Separate Account Mgr • Collective Fund Manager • Custodian	**Functional** • Any individual or entity • Insurance Agents • Registered Reps	**Functional** • Any individual or entity • Custodian

The Functional Investment Advisor Fiduciary

A functional fiduciary role commonly retained by a plan sponsor is a commissioned-based advisor that is relied upon to provide investment recommendations. In this scenario, the plan fiduciary is solely liable for selecting the advisor, selection and performance of the investments unless the commissioned-based advisor's recommendations are the primary basis for investment decisions.[3] If the facts and circumstances bear witness to a trusted advisor relationship where the advisor is relied upon on a regular basis for investment advice tailored to the needs of the plan, the commissioned-based advisor is liable as a functional fiduciary.

Key Point: *A functional fiduciary advisor does not exercise discretionary control but does influence the decision makers. This influence can create liability even without being formally appointed as a fiduciary.*

Although most commissioned-based advisors operate as a function fiduciary unknowingly, only a small percentage accept a formal fiduciary appointment or acknowledge their fiduciary status. Instead, most commissioned-based advisors gravitate toward a functional fiduciary role because they have been trained to develop trusted advisory relationships while offering advice that is incidental to the sale of the investment product. Commission-based sales rely on a suitability and not a fiduciary standard. As a result, commission-based advisors can engage in conflicts of interest if the investment is suitable even though the transaction may be prohibited by ERISA. When commission-based investments are purchased from a non-fiduciary advisor, it is the plan sponsor's in-house fiduciaries that bear the liability for asset allocation decisions, investment selection and performance. It is also worth noting, that most commission-based advisors do not have fiduciary E&O Insurance. As a result, most plan sponsors using the services of a commissioned-based advisor are the deep pockets for monetary damages.

Of course, a fiduciary advisor can also be formally appointed in writing. Those that accept a formal appointment are typically referred to as an Investment Advisor Representative of either a State or SEC Registered Investment Advisor ("RIA"). An RIA is held to a higher fiduciary standard than a commissioned-based advisor; although, an RIA may also engage in a conflict if it is disclosed. However,

[3] A person shall be deemed to be rendering "investment advice" to an employee benefit plan, within the meaning of section 3(21)(A)(ii)… only if…Such person renders advice to the plan as to the value of securities or other property, or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property; and…Such person either directly or indirectly (e.g., through or together with any affiliate)…Renders any advice…on a regular basis to the plan pursuant to a mutual agreement…that such services will serve as a primary basis for investment decisions…and that such person will render individualized investment advice to the plan based on the particular needs of the plan... 29 C.F.R. § 2510.3-21(c)

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there are competent commissioned-based advisors that accept fiduciary status and avoid compensation conflicts.

Regardless of which type of advisor selected, a plan sponsor is obligated to engage in a prudent selection process for service providers paid directly or indirectly from plan assets. Proof of prudence is found in the documented process that was used to select and monitor the advisor. Without documentation there is no proof and without proof the plan sponsor and their fiduciaries are personally underwriting the liability. To mitigate this liability, the plan sponsor should engage in a formal documented process to select or even verify if the existing advisor is qualified to serve the plan in a fiduciary capacity and if the advisor is fulfilling a role that is necessary for the operation of the plan.

What's the Difference in Practical Terms?

Sharing fiduciary responsibility with an advisor is synonymous with sharing fiduciary liability. The amount of liability the advisor assumes is dependent on their role. For example, a fiduciary advisor is responsible for investment advice whereas an investment manager is responsible for exercising investment discretion. The chart above identifies the key differences between two different fiduciary roles commonly occupied by advisors; however, keep in mind that contract terms can influence responsibility and liability.

For More Information

To assist with the identification of an advisor's qualifications, PlanTools™ offers plan sponsors, their ERISA counsel, CPA or consults an RFP system called the "ERISA Advisor Evaluator" ("EAE") that is based on the same principles the courts and legal counsel use to establish expertise. EAE also provides the documentation to support a prudent process. If you are an advisor interested in being pre-vetted to participate in the EAE database, or if you are a sponsor or a sponsor's ERISA counsel, CPA or consultant assisting in the search process and wish to access the EAE system, please write to info@fraplantools.com

	Fiduciary Advisor ERISA § 3(21)(A)(ii)	Investment Manager ERISA §§ 3(21)(A)(i) and 3(38)
Appointment	May be functional or formal	Requires formal appointment
Who Appoints	No formal appointment required	Named Fiduciary or Trustee[4]
Qualifications	Anyone can function or be appointed as a fiduciary	Must be a Bank, Insurance Company or Registered Investment Advisor
Role	Provide investment advice	Take discretionary control of plan assets
Fiduciary Status	May or may not acknowledge	Must acknowledge fiduciary status in writing
Other Obligations	Defined in contract or the arrangement	Dictated by statute and a contract
Sponsor Liability	For selection of the advisor and jointly for investment performance	For selection of the investment manager but not for investments selected or their performance

Fiduciary Risk Assessment ("FRA") provides consulting, expert witness and assessments of advisor expertise. PlanTools™, a wholly owned subsidiary, delivers web-based expense analysis, benchmarking, 408(b)(2) reporting, revenue sharing database, standards-based risk management and fiduciary governance solutions. For more information about FRA/PlanTools contact David J Witz, AIF® GFS™ at 704-564-0482 or dwitz@fraplantools.com

[4] **ERISA § 402(c)(3)** "[a] named fiduciary with respect to control or management of the assets of the plan may appoint an investment manager or managers to manage (including the power to acquire and dispose of) any assets of a plan; **ERISA § 403(a)(2)**…all assets of an employee benefit plan shall be held in trust by one or more trustees…the trustee…shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that--authority to manage, acquire, or dispose of assets of the plan is delegated to one or more investment managers pursuant to § 402(c)(3). **ERISA § 405(d)(1)** If an investment manager or managers have been appointed under § 402(c)(3), then…no trustee shall be liable for the acts or omissions of such investment manager…or be under an obligation to invest or otherwise manage any asset of the plan which is subject to the management of such investment manager.

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