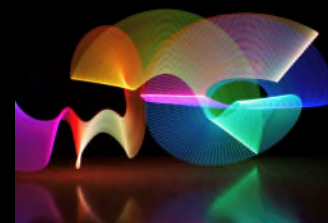


The many faces of fiduciary outsourcing

ERISA sections 3(16), 3(21) and 3(38)



Many employers and outsourcing providers speak in terms of outsourcing fiduciary duties to an ERISA section 3(16), 3(21) or 3(38) “fiduciary.” When they do, they generally are speaking of: outsourcing administrative responsibilities (3(16)); retaining a fiduciary to advise about and assist with fiduciary decisions that they (the plan sponsor) will ultimately make (3(21)); and outsourcing discretionary authority over plan investments (3(38)).

In our experience, these terms are used “colloquially” in discussions about outsourcing in ways that don’t always correspond to the way they are defined by ERISA. For employers, it’s critical to be clear about what authority they are transferring to the outsourcing provider and what duties and liabilities they are retaining. In that regard, terminology matters.

In this article we review the meaning under ERISA of the terms “fiduciary” (ERISA 3(21)), “administrator” (ERISA 3(16)) and “investment manager” (ERISA 3(38)). We then consider, in each case, how those terms are used when discussing outsourcing. Finally, we briefly discuss the significance of these distinctions for purposes of the outsourcing relationship and contracting. We’re providing a separate article on the critical question: “Fiduciary outsourcing: What liability does the sponsor retain?”

Who is a fiduciary? ERISA section 3(21) generally

We begin with ERISA section 3(21) because it defines who a “fiduciary” is, an issue that is relevant for all types of fiduciary outsourcing.

ERISA section 3(21) generally defines a person as a fiduciary to the extent he or she:

1. Exercises any discretionary authority over or control of the management of the plan or the management or disposition of its assets.
2. Renders (or has authority to render) investment advice, for a fee, with respect to plan assets.
3. Has any discretionary authority or discretionary responsibility for plan administration.

Boiling this technical description down: You’re a fiduciary if you (1) have discretion over plan assets, (2) give investment advice for a fee, or (3) have discretion over plan administration.

“Investment advice fiduciaries” under ERISA section 3(21)(A)(ii)

As noted, a person who renders investment advice for a fee is a fiduciary, under ERISA section 3(21)(A)(ii). As we’ll see, this sort of investment advice fiduciary is usually what is meant when the broader term “3(21) fiduciary” is used in colloquial discussions of outsourcing.

“ERISA 3(21) fiduciaries” – in outsourcing

Colloquially, the term “3(21) fiduciary,” when used in connection with outsourcing, is as much a negative designation as a positive one. Positively, it means the outsourcing provider is undertaking, as a fiduciary, to assist and provide advice to, for instance, the plan’s named fiduciary. Negatively, the 3(21) fiduciary generally does not have discretion to make final plan fiduciary decisions.

For example, a 3(21) fiduciary might assist with a manager search, identifying and narrowing the field to three candidates; the final decision about which manager to hire would, however, be made by the plan fiduciary. Thus, generally, for outsourcing, when a person says she is a 3(21) fiduciary, it means that she is an investment fiduciary who does not have discretion. The sponsor is outsourcing research and market insights to an outside party but is retaining decision making authority. As we said above, it's probably best to think of this sort of fiduciary as a 3(21)(A)(ii) investment advice fiduciary.

The plan administrator – ERISA section 3(16) generally

ERISA section 3(16) identifies an ERISA retirement plan's "administrator" as the person so designated by the plan; where the plan does not identify the administrator, the plan sponsor is the administrator. ERISA imposes a number of duties on the administrator, including responsibility for: filing the plan's Form 5500; providing participants with a summary plan description and summaries of material modifications; engaging a plan accountant and (where necessary) a plan actuary; and providing participant fee disclosures.

While ERISA appears generally to treat the plan administrator as a fiduciary, many of an administrator's duties are "non-discretionary." Thus, a plan administrator may be a "fiduciary" for some purposes and not for others, and it is not always clear when an administrator is acting as a fiduciary and when it is not. Moreover, a person (e.g., the plan's "named fiduciary" or a claims appeal committee) may be considered to have "discretionary responsibility for plan administration" even though he, she or it is not the "plan administrator" as designated in the plan document. Such a person would, however, be a fiduciary by virtue of that discretion.

"ERISA 3(16) fiduciaries" – in outsourcing

Colloquially, the designation "3(16) fiduciary," when used in connection with outsourcing, generally means that the outsourcing provider has undertaken to act as the plan administrator for all, or a limited set of, purposes. For example, a 3(16) fiduciary may undertake to handle all participant communications. Some of the outsourcing provider's activity may be non-discretionary in character, e.g., the sending out of a routine plan announcement. Some may be fiduciary in character.

We understand that some of the foregoing discussion may be confusing; that reflects the current lack of clarity in the law. As a practical matter, here is the bottom line: If you want to delegate 3(16) duties (filing the 5500, providing Summary Plan Descriptions, etc.), you generally should do so in the plan document, identifying the outsourcing provider as the plan administrator and clearly describing the duties it will assume. You should also clearly identify who (e.g., which

company official or plan committee) will be responsible for the "administrative" duties the outsourcing provider is not assuming.

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The investment manager – ERISA section 3(38) generally

ERISA section 3(38) identifies a special subset of fiduciaries called "investment managers." An investment manager is a person who is appointed by the plan's named fiduciary to manage, acquire or dispose of plan assets (or a subset of plan assets) and who acknowledges fiduciary status in writing. Only certain persons may be investment managers – banks, insurance companies and investment advisors registered under the 1940 Act or state law.

Where an investment manager is appointed, the plan's trustee is generally relieved of its duty to manage plan assets. The named fiduciary who designates the investment manager, however, remains responsible for the prudent selection and monitoring of the investment manager. That responsibility is generally no different in principle than for any other delegation/appointment.

"ERISA 3(38) fiduciaries" – in outsourcing

Colloquially, the designation "3(38) fiduciary," when used in connection with outsourcing, generally means the fiduciary exercises discretionary fiduciary authority with respect to all or a subset of plan assets. For example, and in contrast with a 3(21) fiduciary, a 3(38) fiduciary would not only undertake a manager search but would also select the managers.

Significance of terminology for the outsourcing relationship

Lawyers may be uncomfortable with the use of, for instance, the term "3(21) fiduciary" to describe an outsourcing provider "without discretion." After all, a "3(38) fiduciary" is *also* a fiduciary under ERISA section 3(21). The point, however, is not to be technically "right" about ERISA, but to make sure that all parties understand what is meant and to create a contract (and a relationship) that is enforceable on that basis – that is, that legally reflects the parties' intentions.

As we discuss in our article “The outsourcing contract,” rather than getting sidetracked by issues of ERISA interpretation, a better approach is to start by first defining the parties’ actual, “real life” roles – what they are actually going to do. Similarly, when you are searching for an outsourcing provider, your focus should be on the services and capabilities of different candidates. The last step (not the first) is to decide for which purposes the outsourcing provider is going to carry the “fiduciary,” “administrator” or “investment manager” label.

In the end, however, technical requirements have to be observed. For instance, as noted, a 3(16) administrator must be designated in the plan document. So, generally, a plan amendment would be necessary to appoint an outsourcing provider as an administrator for purposes of those duties (generally, reporting and disclosure) explicitly assigned to the plan administrator under ERISA.

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Important information

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