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Investment Considerations under ERISA for Defined Contribution Plan Fiduciaries

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Foreword

As more employers offer defined contribution plans, Euclid Specialty underwriters often field inquiries relating to the fiduciary liability exposure of these plans. The common thread in these questions is whether a defined contribution plan eliminates most fiduciary responsibility. While we readily acknowledge that a self-directed defined contribution plan carries less fiduciary risk than a traditional defined benefit plan, we have become concerned that too many plan sponsors are underestimating the fiduciary responsibilities – and thus liability risk – when offering a defined contribution plan. To help answer some of these questions, we asked the ERISA counselors at the Blitman and King, LLP law firm to author a white paper for our producers and policyholders to highlight some of the fiduciary responsibilities faced by plan sponsors of defined contribution plans under ERISA. We hope this white paper on the investment considerations under ERISA for defined contribution plans is useful to anyone considering the need for fiduciary liability insurance protection for their employee benefit plans.

Investment Considerations under ERISA for Defined Contribution Plan Fiduciaries

The Employee Retirement Income Security Act of 1974, as amended ("ERISA") sets forth the regime under which fiduciaries of employee benefit plans need to invest the assets of the plan. In general, the fiduciaries must invest the assets of the plan with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. In addition, the fiduciaries must diversify the plan's investments unless it is clearly prudent not to do so. If the fiduciaries breach these duties, they are subject to personal liability to repay to the plan any losses occasioned by the breach.

Section 404(c) of ERISA provides fiduciaries of certain defined contribution plans some protection from this potential liability where participants and beneficiaries in the plan exercise control over the investment of their accounts. ERISA and the regulations thereunder also extend this protection in the case of certain default investments not actually chosen by the participants and beneficiaries.

However, there are highly technical conditions that must be satisfied to obtain this protection. In addition, although Section 404(c) of ERISA provides fiduciaries some protection from fiduciary liability under ERISA, they nevertheless retain certain fiduciary duties and may still be liable if they fail to discharge those duties consistent with ERISA's mandates. Thus, in no case may the plan fiduciaries merely set and forget the plan's investments.

Furthermore, to the extent the plan fiduciaries seek to hire an investment professional to assist them in complying with Section 404(c) of ERISA or their remaining investment duties, the plan fiduciaries need to be aware of the legal status of the professional they are engaging. While often times it may seem that different types of professionals are providing similar services, slight nuances in the legal structure of the arrangement between the plan and the professional could make the difference regarding the extent to which the plan fiduciaries should rely on the advice and recommendations of the professional in connection with the performance of their duties under ERISA.

I. Legal Framework Governing Defined Contribution Plan Investments

Under ERISA, a "defined contribution plan," or an "individual account plan," is a pension plan that provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account and any income, expenses, gains, and losses attributable thereto.[1] The most common example of an individual account plan where participants can direct the investment of their accounts is a 401(k) plan, but there are also other types of plans that fit this description.

The general investment rules under ERISA apply to these plans. However, if the plan offers participants and beneficiaries the opportunity to direct the investment of their respective plan accounts and the plan fiduciaries comply with the technical regulations, the fiduciaries will be

[1] 29 U.S.C. § 1002(34).

absolved from some potential ERISA fiduciary liability in connection with the participants' and beneficiaries' investment directions.

A. General Investment Duties under ERISA Section 404(a)

Section 404(a) of ERISA requires fiduciaries of employee benefit plans to discharge their duties with respect to the plan with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.[2] This is commonly referred to as the ERISA standard of care.

With respect to plan investments, regulations promulgated by the U.S. Department of Labor ("Department") provide that the ERISA standard of care is satisfied if a fiduciary has (1) given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties; and (2) acted accordingly.[3]

Section 404(a) of ERISA also requires plan fiduciaries to diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.[4] In addition, the fiduciaries must administer the plan in accordance with the documents and instruments governing the plan to the extent they are consistent with Title I of ERISA.[5]

Complying with these investment duties is crucial for plan fiduciaries. Not only could a fiduciary breach lead to a potential loss of participants' retirement savings within the plan, but the fiduciaries are subject to personal liability under ERISA to make good to the plan any losses caused by such a breach and to any other remedial or equitable relief a court deems appropriate.[6]

B. Protection under ERISA Section 404(c)

Section 404(c) of ERISA provides fiduciaries with protection from some fiduciary liability where the plan is a defined contribution plan that permits participants and beneficiaries to exercise control over assets in their respective plan accounts. In other words, provided that the technical rules are followed and the plan gives participants and beneficiaries the ability to direct the investment of the assets in their plan accounts, the plan fiduciaries are protected from certain liability with respect to such investments.

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[2] 29 U.S.C. § 1104(a)(1)(B).

[3] 29 C.F.R. § 2250.404a-1(b)(1).

[4] 29 U.S.C. § 1104(a)(1)(C).

[5] 29 U.S.C. § 1104(a)(1)(D).

[6] 29 U.S.C. § 1109(a).

1. General Rule

If the plan is structured to comply with Section 404(c) of ERISA and the regulations thereunder, then (1) the participant or beneficiary will not be deemed a "fiduciary" under ERISA by reason of his or her exercise of control; and (2) no person who is otherwise a fiduciary (i.e., the trustees or investment committee) will be liable for any loss, or by reason of any breach, which results from such exercise of control.[7] However, nothing in these rules absolves plan fiduciaries from their duty to select and monitor the plan's investment options pursuant to the ERISA standard of care and other fiduciary duties set forth above.

In general, the rules require the plan to give plan participants and beneficiaries the right to exercise control over the investment of their individual accounts, to establish the available investment lineup pursuant to various conditions, and to comply with certain disclosure rules. More specifically, these rules require the plan fiduciaries to construct the plan's investment lineup to offer a "broad range of investment alternatives." This requires giving participants and beneficiaries a reasonable opportunity to materially affect the potential investment return on their accounts and the degree of risk in the investments, choose from at least three investment alternatives with various characteristics set forth in the regulations,[8] and diversify the investments in their accounts.[9]

In addition, the plan must provide participants and beneficiaries with sufficient information to make informed investment decisions in connection with the plan's investment options.[10] This includes an explanation that the plan is intended to constitute a plan described in Section 404(c) of ERISA and the fiduciary consequences thereof, and the fee disclosures required under the Department's participant-level fee disclosure regulations.[11]

The protection afforded to plan fiduciaries by Section 404(c) of ERISA generally applies only where a participant or beneficiary has actually exercised independent control with respect to the investment of the assets in his or her account or with respect to similar rights appurtenant to the ownership in

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[7] 29 U.S.C. § 1104(c)(1)(A); 29 C.F.R. § 2550.404c-1(b)(1).

[8] Under the regulations, the investment alternatives each must (1) be diversified and have materially different risk and return characteristics, (2) in the aggregate, enable the participant to achieve a portfolio with aggregate risk and return characteristics, and (3) when combined with investments in the plan's other investment alternatives, tend to minimize through diversification the overall risk of the participant's portfolio. 29 C.F.R. § 2250.404c-1(b)(3)(i)(B).

[9] 29 C.F.R. § 2550.404c-1(b)(3)(i).

[10] 29 C.F.R. § 2550.404c-1(b)(2)(i).

[11] *Id.* Under these fee disclosure regulations, a plan administrator is required to provide each participant an explanation of administrative fees (e.g., legal, accounting, recordkeeping) that may be charged and are not reflected in the total annual operating expenses of the plan's investment options, as well as the basis on which the charges will be allocated to each individual account. In addition, the plan must disclose information concerning the fees charged by the specific plan investment options and any fees charged directly to accounts that were not charged on a plan-wide basis (e.g. fees in connection with a loan or qualified domestic relations order). *See* 29 C.F.R. § 2550.404a-5.

an investment fund (i.e., voting, tender, or similar rights).[12] There are also detailed rules that can extend the protection in special circumstances described below.[13]

2. *Special Rules Extending ERISA Section 404(c) Protection*

Even if a plan gives participants and beneficiaries the ability to direct the investment of their plan accounts, there are certain circumstances where an investment may need to be made or changed absent any direction. This may occur where the plan fiduciaries, as part of their duty to monitor the investment lineup, change the investment options available under the plan or where the participant or beneficiary simply fails to give any investment direction. Recognizing that these scenarios could cause the plan to fail to comply with the technical rules under Section 404(c) of ERISA due to a lack of an exercise of control, the statute and regulations extend the protection if certain conditions are satisfied.

a. *Investment Mapping*

As noted above, even where a plan is structured to comply with and be protected by Section 404(c) of ERISA, plan fiduciaries nevertheless retain fiduciary responsibility concerning the selection and monitoring of the investment options on the plan's lineup. In the event the plan fiduciaries determine that it is necessary or desirable to remove or replace investment options, the fiduciaries may decide to transfer plan assets from existing options to the different or new options offered under the plan. This is generally referred to as "mapping" investments.

Because a participant or beneficiary did not actually exercise control to make this change, the technical requirements of Section 404(c) would not be satisfied with respect to the investment in the new option. However, Section 404(c)(4) of ERISA accounts for this and extends the protection if certain conditions are satisfied.

Under Section 404(c)(4) of ERISA, when a "qualified change in investment options" occurs, the change will still be protected under Section 404(c) if certain requirements are met.[14] A "qualified change in investment options" occurs where the participant's or beneficiary's plan account is reallocated among one or more remaining or new investment options offered in lieu of one or more previously-existing options, and the stated characteristics of the remaining or new options are, as of immediately after the change, reasonably similar to those of the existing options immediately before the change.[15]

To maintain Section 404(c) protection with respect to the change, the following conditions must be met: (1) at least 30 days and no more than 60 days prior to the effective date of the change, the plan must furnish written notice of the change to participants and beneficiaries, including information

[12] 29 C.F.R. § 2550.404c-1(c).

[13] 29 U.S.C. § 1104(c)(4)(A)-(C).

[14] 29 U.S.C. § 1104(c)(4)(A).

[15] 29 U.S.C. § 1104(c)(4)(B).

comparing the existing and new investment options and an explanation that, in the absence of affirmative investment instructions to the contrary, the participant's or beneficiary's account will be reallocated; (2) the participant or beneficiary does not provide to the plan, in advance of the effective date of the change, affirmative investment instructions contrary to the change; and (3) the participant's or beneficiary's investments under the plan as in effect prior to the effective date of the change were the product of the exercise of control by the participant or beneficiary, within the meaning of Section 404(c)(1) of ERISA.[16]

b. Default Investments

In order to encourage automatic enrollment for contributions to plans, Congress expanded the protection offered under Section 404(c) of ERISA in the Pension Protection Act of 2006 by adding the new subsection, 404(c)(5).[17] This subsection provides that a participant will be treated as "exercising control" over the assets in his or her plan account for purposes of Section 404(c) even if the participant does not make an affirmative investment election, provided that the account is invested in a default investment in accordance with Department regulations.[18] In other words, the plan fiduciaries can be protected in the circumstance where a participant fails to select any investment under the plan, either due to his or her automatic enrollment in the plan or otherwise.

Under the corresponding regulations, in the event that a participant is given the opportunity to choose from a broad range of investment alternatives but does not, the plan fiduciaries are protected under Section 404(c)(1) of ERISA if the plan invests the account in a "qualified default investment alternative" ("QDIA") and satisfies certain notice requirements.[19] In addition, the plan must permit the participant to elect to transfer his or her account from the QDIA to the other investment alternatives offered under the plan as set forth in the regulations.[20]

In order to qualify as a QDIA under the regulations,[21] the investment alternative must (1) not hold any employer securities; (2) permit the participant to transfer his or her investment to another alternative with limited restrictions; (3) be managed by an investment manager, an investment company, the plan sponsor (or a committee thereof), or for no more than 120 days after the participant's first elective contribution to the plan, an investment product or fund designed to

[16] 29 U.S.C. § 1104(c)(4)(C). As a result of this third prong, the mapping rule does not extend to a situation where a participant or beneficiary initially failed to choose an investment option and was instead defaulted into his or her plan investment.

[17] 29 U.S.C. § 1104(c)(5).

[18] 29 U.S.C. § 1104(c)(5).

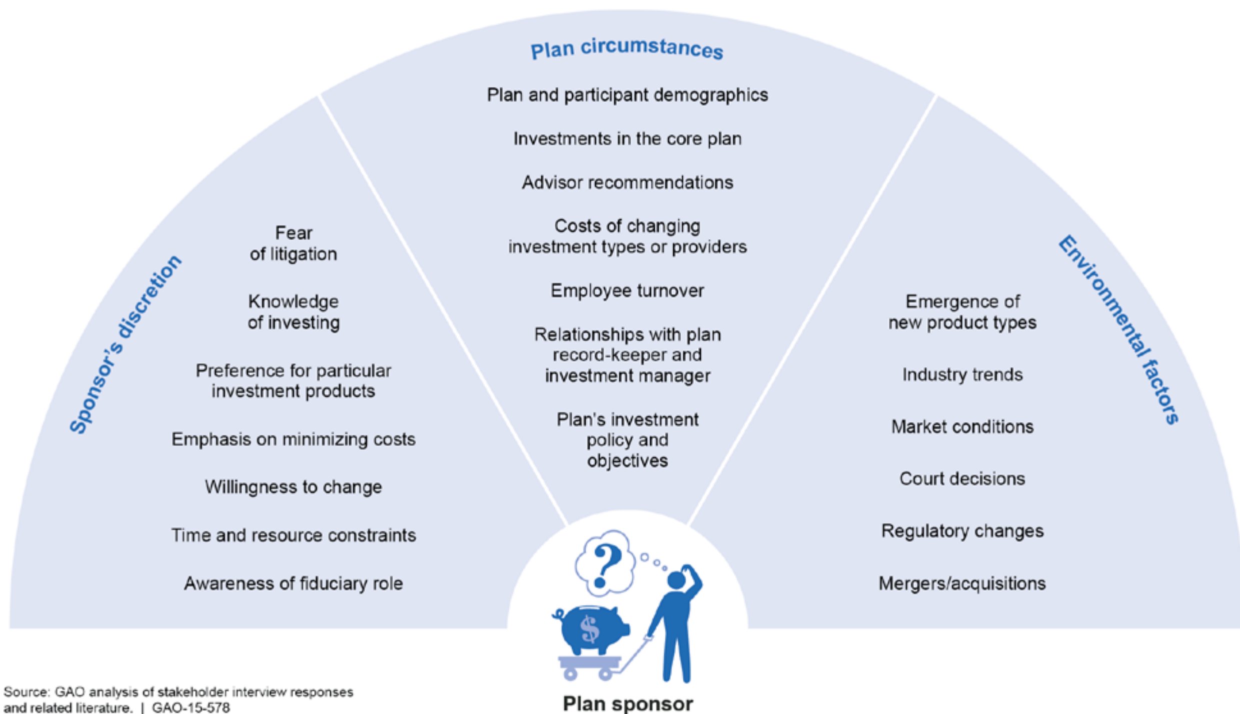
[19] 29 C.F.R. § 2550.404c-5(b)-(c).

[20] 29 C.F.R. § 2550.404c-5(d).

[21] 29 C.F.R. § 2550.404c-5(e).

preserve principal and provide a reasonable rate of return; and (4) be a target date fund,[22] a balanced fund,[23] or a managed account.[24]

According to a recent report from the U.S. Government Accountability Office ("GAO"), a combination of the plan sponsor's perceptions, plan circumstances, and environmental factors influence how a plan sponsor approaches QDIA selection and the type of QDIA selected.[25] As demonstrated in the following illustration that appeared in the GAO report, at the top of the list of factors that might influence a plan sponsor's QDIA selection is a fear of litigation.



Source: GAO analysis of stakeholder interview responses and related literature. | GAO-15-578

[22] A target date fund, referred to in the regulations as a life-cycle fund, is an investment fund, product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses, and is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date, or life expectancy. 29 C.F.R. § 2550.404c-5(e)(4)(i).

[23] A balanced fund is an investment fund, product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses, and is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed income exposures consistent with a target level of risk appropriate for participants of the plan as a whole. 29 C.F.R. § 2550.404c-5(e)(4)(ii).

[24] A managed account is an investment management service with respect to which an investment manager or plan sponsor, applying generally accepted investment theories, allocates the assets of a participant's individual account to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures, offered through investment alternatives available under the plan, based on the participant's age, target retirement date, or life expectancy. 29 C.F.R. § 2550.404c-5(e)(4)(iii).

[25] GAO, Default Investments in 401(k) Plans, GAO-15-578 (August 2015).

As with all decisions pertaining to the establishment and maintenance of the plan's investment lineup, nothing in the QDIA rules relieves fiduciaries from their duty to select and monitor any QDIA in accordance with the ERISA standard of care or from any liability that results from a failure to do so. Thus, the plan fiduciaries need to be sure to prudently select and monitor the plan's QDIA, unless the role is property delegated under ERISA.

C. Limits to ERISA Section 404(c) Protection

As noted, despite the fiduciary protection offered by Section 404(c) of ERISA, the rules explicitly do not serve to relieve plan fiduciaries from their duty to prudently select and monitor any service provider or investment option offered under the plan.[26] As such, plan fiduciaries not only need to be concerned about complying with the technical rules underlying Section 404(c) of ERISA, but also the ERISA standard of care and other fiduciary duties with respect to the plan's investment lineup. As described by a U.S. Federal District Court, "[w]here the options available to participants are tainted by conflicts of interest or imprudent management, a party should not be able to avoid liability simply by providing participants the opportunity to exercise control over their accounts."[27]

The U.S. Court of Appeals for the Fourth Circuit has noted that, "although section 404(c) does limit a fiduciary's liability for losses that occur when participants make poor choices from a satisfactory menu of options, it does not insulate a fiduciary from liability for assembling an imprudent menu in the first instance."[28] In that case, a group of employees argued that, among other things, the failure to remove the employer's stock as an investment option offered by the plan violated the ERISA standard of care.[29] The Fourth Circuit affirmed the district court's judgment in favor of the employer, which noted that the employer offered twelve diversified investment options and allowed participants to transfer their assets freely between the options, and the plan documents repeatedly noted the risks associated with a non-diversified retirement portfolio in general and an investment in the employer's stock.[30] Thus, compliance with the general conditions underlying Section 404(c) of ERISA saved the plan fiduciaries from potential liability.

In contrast, a U.S. Federal District Court in California refused to grant summary judgement to an employer, the plan administrator, and an investment advisor providing services to the plan who claimed in the case that their actions were protected under Section 404(c) of ERISA.[31] The investment advisor was a company that originated as an in-house investment advisory and management division of the employer and was eventually spun off as a separate corporation, all

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[26] 29 C.F.R. § 2550.404c-1(d)(2)(iv).

[27] *Kanawi v. Bechtel Corp.*, 590 F. Supp. 2d 1213, 1232 (N.D. Cal. 2008).

[28] *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418 n.3 (4th Cir. 2007).

[29] *Id*. at 424.

[30] *Id*. at 420-21.

[31] *Kanawi*, 590 F. Supp. 2d at 1233.

while continuing to provide services to the plan.[32] Plan participants sued the defendants, alleging that this close relationship was a breach of fiduciary duty that resulted in imprudent decision-making, causing participants to incur unnecessary and improper fees in connection with the plan.[33] In concluding that Section 404(c) of ERISA likely did not apply as a defense to these allegations, the court noted that "[t]he DOL has taken a clear position that § 404(c) does not shield a party from liability for claims of imprudent selection of Plan investment options."[34]

Furthermore, even if the initial selection of an investment on the plan's lineup is prudent, the plan fiduciaries remain responsible for monitoring the continued prudence of the investment options and removing imprudent ones. As noted by the U.S. Supreme Court in the *Tibble* decision in 2015, "[t]his continuing duty [to monitor investments and remove imprudent ones] exists separate and apart from the [fiduciaries'] duty to exercise prudence in selecting investments at the outset."[35] The Supreme Court cited principles under the common law of trusts involving fiduciaries' responsibility to systematically exercise a reasonable degree of diligence to consider the trust's investments at regular intervals to ensure their continued appropriateness.[36]

The risk to plan fiduciaries goes further than a potential court case brought by a participant over the plan's investment lineup. The fiduciaries' actions are always subject to an investigation or enforcement action by the Department.[37] Moreover, even if the plan fiduciaries ultimately prevail in an action brought by a participant or the Department, they are likely to incur large expenses in defending against the allegations of imprudence. As a result, the fiduciaries have a great incentive to comply with Section 404(c) and employ a prudent process with respect to the selection and monitoring of the plan's investment options to pre-emptively dissuade potential claims.

II. CONSIDERATIONS FOR ENGAGING INVESTMENT-RELATED PROFESSIONALS

In light of the potential consequences associated with a breach of fiduciary duty under ERISA, fiduciaries often look for assistance from investment professional service providers with respect to the plan's investment lineup. The types of investment professionals generally available to fiduciaries of participant-directed defined contribution plans include investment platform providers/recordkeepers, non-discretionary investment consultants, and discretionary investment managers.

In taking purported advice or recommendations from these entities, the plan fiduciaries need to be aware of the role of the investment professional under ERISA, as the recourse the plan fiduciaries may have against the professional in connection with relying on its advice or recommendations can

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[32] *Id.*

[33] *Id.* at 1220.

[34] *Id.* at 1231.

[35] *Tibble et al. v. Edison Int'l et al.*, 575 U.S. ___, 135 S. Ct. 1823, 1828 (2015).

[36] *Id.*

[37] 29 U.S.C. § 1132(a).

vary greatly depending on whether the professional provides services as an ERISA fiduciary of the plan. Under current Department regulations, an entity will be providing fiduciary investment advice if:

1. The entity provides asset valuations or makes recommendations as to the advisability of investing in, selling, or purchasing of assets or other property,

2. The advice is provided on a regular basis,

3. The advice is provided pursuant to a mutual agreement, arrangement, or understanding with the plan or a fiduciary thereof,

4. The advice will serve as a primary basis for investment decisions for plan assets, and

5. The advice is individualized based on the particular needs of the plan.[38]

Even if the professional serves as a fiduciary to the plan, the other plan fiduciaries may nevertheless be liable for the professional's act or omission. This is because Section 405 of ERISA provides that a plan fiduciary can be liable for a breach of fiduciary responsibility by another plan fiduciary if (1) he or she participates knowingly in, or knowingly undertakes to conceal, an act or omission of the other fiduciary, knowing such act or omission is a breach; (2) by his or her failure to comply with ERISA Section 404(a)(1), he or she has enabled the other fiduciary to commit a breach; or (3) he or she has knowledge of a breach by the other fiduciary, unless he or she makes reasonable efforts under the circumstances to remedy the breach.[39] An exception to this co-fiduciary liability rule is where the plan's fiduciaries appoint an investment manager pursuant to Section 402(c)(3) of ERISA. In that case, the plan fiduciaries can be insulated from liability with respect to the acts or omissions of the investment manager.[40]

These legal distinctions are important because the structure of the arrangement between the plan and the investment professional could determine whether the provider stands beside or in front of the plan fiduciaries in a breach claim concerning the plan's investment options, or whether the investment professional is insulated from ERISA liability on account of not being a fiduciary of the plan at all.

A. Investment Platform Providers/Recordkeepers

The first type of professional often engaged by plan fiduciaries is the investment platform provider/recordkeeper. The platform provider/recordkeeper generally makes the investment lineup available to the plan and often performs other recordkeeping and administrative services.

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[38] 29 C.F.R. § 2510.3-21(c)(1). In April 2015, the Department proposed new regulations which clarify and expand the definition of fiduciary investment advice under ERISA. *See* 80 Fed. Reg. 21928 (Apr. 20, 2015).

[39] 29 U.S.C. § 1105(a).

[40] 29 U.S.C. § 1105(d)(1).

This entity often attempts to specifically disclaim any fiduciary liability with respect to its making the lineup of options available and to represent that it only performs ministerial, non-fiduciary functions with respect to recordkeeping and administration. Despite these fiduciary disclaimers, the provider may still present the plan fiduciaries with detailed information about potential investment options that could be offered, including analysis and commentary about the options or a grade or score assigned by the provider (or its investment manager affiliate) to each.

If the plan's fiduciaries are challenged under ERISA for improper selection or maintenance of the plan's investment lineup, the fiduciaries will only be able to involve the provider as a co-fiduciary under ERISA if its distribution of these materials and purported recommendations and analysis result in the provider being deemed a functional fiduciary under ERISA. In this context, and depending on the nature of the information furnished by the provider, the plan's fiduciaries may have arguments that the information satisfies the test under the Department regulations set forth above.

However, the provider will likely argue that all such information, even to the extent it purports to recommend certain investment options over others (either directly or through a scoring system), is, among other things, not individualized based on the needs of the plan or provided pursuant to a mutual agreement, arrangement, or understanding. The latter point may be especially pertinent to the extent the plan's agreement with the provider indicates that any such information furnished is general and for education only, and is not to be relied on by the plan fiduciaries in making investment decisions.

Even though the provider's actions and arrangement may not make it a fiduciary under ERISA with respect to the plan, the plan fiduciaries may still be able to point to any general investment materials furnished to and reviewed by them as part of their prudent decision-making process with respect to selecting and monitoring the plan's investment lineup. However, they should be aware of the legal nature of the provider's relationship to the plan and understand that the provider may not be acting pursuant to ERISA's strict fiduciary duties and prohibited transaction rules against conflicts of interest and self-dealing. Further, in the event the plan fiduciaries' investment decisions are later challenged under ERISA, they may have no co-fiduciary recourse against the provider solely on the basis of those materials.

B. Non-Discretionary Investment Consultants

The second type of investment professional is the non-discretionary investment consultant. This service provider generally acknowledges its status as a "fiduciary" under Section 3(21) of ERISA and agrees to provide the plan fiduciaries with recommendations for the selection and maintenance of the investment lineup. In addition to an express acknowledgement of the consultant's status, the arrangement with the consultant should also be structured to make certain that the advice given meets the definition of fiduciary "investment advice" in the Department's regulations, as discussed above.

The consultant is generally asked to review and report on the plan's investment options and to make recommendations regarding the potential addition, subtraction, or replacement of options and whether the fees charged by the respective investment options are reasonable. In addition, because of the importance to the plan fiduciaries of structuring the lineup to comply with Section 404(c) of ERISA, they should solicit opinions and assistance from the consultant as to whether the lineup is

appropriately structured to obtain the maximum protection from that section, including with respect to its initial establishment, the plan's default investment options, and any changes to the lineup and transfers in connection therewith.

However, the plan fiduciaries need to be aware that in this type of arrangement they retain the final authority for the plan's investment decisions. The consultant is merely providing opinions and recommendations that the fiduciaries must accept or reject. While, unlike a non-fiduciary provider, the consultant can be subject to co-fiduciary liability under ERISA with respect to purported fiduciary breaches by the plan fiduciaries based on their following the consultant's advice and recommendations,[41] the consultant merely stands beside the plan fiduciaries in the action. The plan fiduciaries remain subject to the same co-fiduciary liability based on their ultimate discretion with respect to the acceptance of such advice and recommendations. In addition, as with other service providers, the plan fiduciaries remain responsible for monitoring the consultant and confirming that the arrangement between the plan and consultant, including the fees charged, is prudent under ERISA.

C. Discretionary Investment Managers

Plan fiduciaries can obtain even more protection under ERISA by engaging an investment professional to serve as an "investment manager" under Section 3(38) of ERISA with respect to the plan's investment lineup. Under that section, an "investment manager" is a fiduciary (other than a trustee or named fiduciary) who: (1) has the power to manage, acquire, or dispose of any asset of the plan; (2) is a registered investment adviser under the Investment Advisers Act of 1940 or state law, a bank, or an insurance company, and (3) has acknowledged in writing that it is a fiduciary with respect to the plan.[42]

Upon delegation of investment duties to an entity that qualifies as an "investment manager" under ERISA, the plan fiduciaries are not liable for the acts or omissions of the investment manager with respect to its management of the plan's assets.[43] In other words, the investment professional serves as a discretionary manager to whom authority is delegated to set and monitor the plan's lineup without further approval needed by the plan fiduciaries, and the fiduciaries are protected from liability with respect to the investment manager's setting and monitoring the lineup.

The plan's contract with the investment manager should clearly set forth the delegated duties of the manager with respect to the plan's investment lineup. There should be no doubt that the professional is serving as a discretionary investment manager, making reference to Section 3(38) of ERISA. The plan fiduciaries may also want to require the investment manager to comply with Section 404(c) with respect to its establishment and maintenance of the investment lineup to provide added protection both through the delegation to the investment manager and the insulation created by Section 404(c).

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[41] 29 U.S.C. § 1105(a).

[42] 29 U.S.C. § 1002(38).

[43] 29 U.S.C. § 1105(d)(1).

Despite the delegation to the investment manager, the plan fiduciaries nevertheless remain liable for monitoring the manager to ensure that the delegation remains prudent. As noted above, the U.S. Supreme Court in *Tibble* recently confirmed the plan fiduciaries' continuing duty to monitor investments to ensure continued prudence, and the same analysis would apply to their delegation of investment decisions to an investment manager. In addition, the plan fiduciaries must confirm that no more than reasonable compensation is paid to the investment manager for its services on behalf of the plan.[44] In light of this, the plan fiduciaries should require and review periodic reports concerning the manager's decisions and performance with respect to the plan's lineup and the manager's fees in connection with its services.

III. CONCLUSION

ERISA sets forth a comprehensive scheme of duties in connection with plan fiduciaries' investment of plan assets. Fiduciaries of defined contribution plans are incentivized to give participants investment control over their plan accounts and to comply with Section 404(c) of ERISA. However, plan fiduciaries need to take care to comply with the technical requirements concerning the establishment and maintenance of the plan's investment lineup, disclosures required to be sent to participants and beneficiaries, and special situations involving changed or default investment options.

Moreover, while plan fiduciaries may attempt to delegate these investment duties to an investment professional, the type of relief afforded the fiduciaries with respect to the delegation can vary greatly based on the arrangement between the plan and professional. Even with such a delegation, the plan fiduciaries are likely going to retain some responsibility with respect to the plan's investments, which could range from being required to sign off on and own all investment-related decisions, to monitoring the investment professional's fees and performance.

This is important for plan fiduciaries because the risks of non-compliance are great. Not only are they subject to potential personal liability if found to have committed a fiduciary breach, but the mere defense against an allegation of such a breach, raised either by a participant or beneficiary or the Department, will likely result in considerable effort and expense.

[44] 29 U.S.C. § 1108(b)(2).

About the Authors

Jonathan M. Cerrito, Esq.

Jonathan Cerrito is a Partner in Blitman & King's New York office, where he represents plan sponsors and fiduciaries of employee benefit plans. Having defended against dozens of governmental investigations and litigation brought by the Department of Labor, he has significant experience handling ERISA controversies particularly those involving fiduciary matters and alleged statutory violations. Jonathan recently served as counsel to six different plans being investigated by the DOL pertaining to potential breach of fiduciary duties in connection with the plans' investments. And, as lead ERISA counsel for approximately 40 pension plans that were invested in a liquidating hedge fund, he recently structured a $200 million dollar settlement that involved the retention of two independent fiduciaries and the distribution of investment proceeds.

Nevertheless, in an industry based on logic and precedent, Jonathan separates himself from the pack because he brings imagination, intuition and an entrepreneurial spirit to his practice. He has been recognized by Super Lawyers as a Rising Star in the New York Metro area.

Michael R. Daum, Esq.

Michael R. Daum is an attorney with Blitman & King LLP in Syracuse, New York. He concentrates his work on various employment and employee benefits matters, including the fiduciary aspects of investing plan assets and representing plans and fiduciaries in connection with investigations by the U.S. Department of Labor. Mike has represented plans and fiduciaries in connection with the investment of an aggregate of over $100 million in plan assets by reviewing and negotiating the terms of potential investments from a legal perspective.

About Euclid Specialty Managers, LLC

Euclid Specialty is a leading provider of fiduciary liability insurance for multiemployer, governmental and other non-profit employee benefit funds. Euclid Specialty is part of the Euclid Program Managers family of underwriting companies that write over $75 million in professional liability premium for several leading program insurance companies. Professional liability brokers come to Euclid Specialty to protect their employee benefit plan clients, because our underwriters and claims professionals are all experienced ERISA and fiduciary liability insurance experts. For more information, contact John O'Brien at jobrien@euclidspecialty.com or 440-714-5832.

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