Outsourcing Fiduciary Responsibility – Know Your Options

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Overview of Presentation

- Statutory framework for outsourcing fiduciary responsibilities
- Outsourcing plan investment responsibilities
- Outsourcing plan administrative responsibilities
- Pooled employer plans

Statutory Framework for Outsourcing Fiduciary Responsibilities

Fiduciary Definition – ERISA § 3(21)

- A person is a fiduciary with respect to an employee benefit plan to the extent such person:
  - Exercises any discretionary authority or discretionary control respecting management of the plan;
  - Has any discretionary authority or discretionary responsibility in the administration of the plan;
  - Exercises any authority or control respecting management or disposition of the plan's assets; or
  - Renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan, or has any authority or responsibility to do so
- ERISA distinguishes between decisions made by a plan sponsor on behalf of its business ("settlor" decisions) and decisions made in a fiduciary capacity
  - Settlor decisions include establishing, amending and terminating a plan

Named Fiduciary – ERISA § 402(a)

- An ERISA plan's governing documents must provide for one or more "named fiduciaries" who, jointly or severally, have authority to control and manage the operation and administration of the plan
- Each named fiduciary must either be named in the plan's governing documents or identified as a named fiduciary by the plan sponsor pursuant to a procedure specified in the plan
- Examples: plan sponsor, trustee, plan administrator, administrative committee, investment committee

Investment Manager – ERISA § 3(38)

- An "investment manager" is a fiduciary to whom a named fiduciary has delegated the power to manage, acquire or dispose of assets of an employee benefit plan
- Only a bank, insurance company, or registered investment adviser can act as an investment manager
- An investment manager must acknowledge its fiduciary status in writing

Plan Administrator – ERISA § 3(16)

- The plan administrator is responsible for managing the day-to-day operations of the plan
- If the plan's governing documents do not designate a plan administrator, the plan sponsor is deemed to be the plan administrator
- The duties of a plan administrator include:
  - Determining employee eligibility;
  - Signing and filing Form 5500 annual reports;
  - Furnishing SPDs, benefit statements, notices and disclosures to participants;
  - Engaging an accountant to conduct audits of the plan's financial statements;
  - Approving and processing loans and distributions; and
  - Ensuring that the plan is operated in accordance with its terms
- Persons who perform administrative functions for a plan within a framework of policies, procedures and rules developed by others are not considered fiduciaries

Fiduciary Duties – ERISA § 404

- A plan fiduciary, in performing its fiduciary functions, is subject to:
  - A duty of loyalty, which requires the fiduciary to act solely in the interests of plan participants and beneficiaries and for the exclusive purpose of providing benefits defraying reasonable administrative expenses;
  - A duty of prudence, which requires the fiduciary to exercise the same care, skill and diligence that a "prudent expert" would use in similar circumstances;
  - A duty to diversify plan investments to minimize the risk of large losses; and
  - A duty to act in accordance with terms of the plan's governing documents (to the extent such terms are consistent with ERISA)

Liability for Fiduciary Breach – ERISA § 409

- A fiduciary that breaches his or her fiduciary duties to a plan may be required to:
  - Reimburse the plan for any losses resulting from the breach;
  - Restore to the plan any profits made by the fiduciary through its use of the plan's assets;
  - Pay a 20% penalty to the DOL on amounts recovered by the DOL on behalf of the plan;
  - Pay prohibited transaction excise taxes; and
  - Provide other relief deemed appropriate by a court

Co-Fiduciary Liability – ERISA § 405

- A plan fiduciary will be liable for a breach committed by another fiduciary of the same plan if he or she:
  - Knowingly participates in, or knowingly undertakes to conceal, an act or omission of the other fiduciary, knowing that such act or omission is a breach;
  - Fails to comply with his or her own fiduciary duties, and in so doing enables the other fiduciary to commit a breach; or
  - Has knowledge of a breach by such other fiduciary and fails to make reasonable efforts under the circumstances to remedy the breach

Delegation of Fiduciary Responsibilities – ERISA § 402

- If permitted under the plan documents, a named fiduciary may:
  - Employ one or more persons to render advice regarding any of its responsibilities under the plan;
  - Appoint one or more investment managers to manage, acquire and dispose of assets of the plan; or
  - Using procedures specified in the plan, allocate fiduciary responsibilities (other than investment management responsibilities) to other named fiduciaries or delegate such fiduciary responsibilities to persons other than named fiduciaries

Delegation of Fiduciary Responsibilities (cont'd)

- A named fiduciary who employs investment and other advisers is not relieved of his or her own fiduciary responsibilities merely by following the advice of such persons;
- Except as provided under ERISA's co-fiduciary liability provisions, a named fiduciary will not be liable for:
  - the acts or omissions of the investment manager, provided the named fiduciary has not breached its fiduciary duties in connection with the selection and retention of the investment manager; or
  - the acts or omissions of persons to whom the it has allocated or delegated fiduciary responsibilities other than investment management responsibilities, provided the named fiduciary has not breached its fiduciary duties in connection with the initial allocation or delegation, the continuation of the allocation or delegation, or the establishment or implementation of the allocation or delegation procedures

Selection of Fiduciary Service Providers

- DOL guidance identifies various factors that a named fiduciary should consider in selecting fiduciary service providers, including:
  - The qualifications of the service provider
  - The quality of the work product; and
  - The reasonableness of the service provider’s fees
- A named fiduciary that does not have the expertise needed to evaluate service providers may engage consultants and other experts to assist with the task of selecting service providers
- A named fiduciary needs to consider the application of ERISA’s prohibited transaction rules, which prohibit the furnishing of services to a plan by a “party in interest”

Monitoring of Fiduciary Service Providers

- A named fiduciary who appoints a person to perform fiduciary functions has a duty to monitor the service provider's performance at reasonable intervals
- No single procedure for monitoring appointed fiduciaries will be appropriate in all cases
- Depending on the circumstances, a named fiduciary may satisfy its duty to monitor by a formal periodic review or through day-to-day contact and evaluation

Outsourcing Plan Investment Responsibilities

Types of Investment Outsourcing Arrangements

- Each of the following types of investment services/proposals provide some level of fiduciary "outsourcing" from plan committees for investment-related plan services
  - Investment Advisory and Non-Discretionary Investment Committee Support Services (generally referred to as "Fiduciary Consulting" or "3(21) Services")
  - Discretionary Investment Management Services (ERISA Section 3(38) delegation)
  - "Outsourced Chief Investment Officer" ("OCIO") Services
  - "Independent Fiduciary" Services (may be discretionary or non-discretionary)

3(38) Discretionary Consulting

- Gaining in popularity among plan fiduciaries as a way to mitigate risk.
- Handing over the “Keys to the Car” as it relates to investment selection, monitoring and replacement.
- May be a good solution for plan fiduciaries who lack investment expertise or the time to manage plan investments.
- May be offered as a product (set investment menu) or fully customizable based on specific plan needs.
- May allow a plan to access lower fee investments (*i.e.*, Collective Investment Trusts).

3(38) Roles and Responsibilities

Covered Services	3(21) Traditional Consulting	3(38) Investment Management	
	Client	Client	Advisor
Discovery & Strategy	✓	✓	✓
Define Objectives	✓	✓	✓
Risk & Return Goals	✓	✓	✓
Investment Menu Review	✓	✓	✓
Implementation			
Sub-Asset Class Structure	✓	✓	✓
Manager Selection	✓		✓
Manager Termination/Transition	✓		✓
Mapping Strategies	✓		✓
Ongoing Oversight & Evaluation			
Vendor Relations	✓	✓	✓
Fee Benchmarking	✓	✓	✓
Manager Compliance	✓		✓
Investment Policy Statements	✓	✓	✓

3(38) Discretionary Consulting Considerations

- Fiduciary decision to retain a 3(38) Investment Consultant for your Plan.
- Limited flexibility with timing of potential investment changes.
- No control over investment manager selection process.
- Monitoring process needed over 3(38) Investment Consultant.
- May increase cost to the Plan or Company.

OCIO Arrangements

- Types of OCIO Services: No uniform definition, but a range of approaches
  - Full Outsourcing: Outsource all decision making, including asset allocation, manager selection and monitoring from the Committee/Named Fiduciary to OCIO
    - Investment Line-Up: Usually some type of commingled funds or model portfolios – may include manager-of-manager programs, funds-of-funds offering scale, proprietary and/or non-proprietary investment options (and usually, but not always, lower fees)
    - Typically classified as ERISA Section 3(38) or “named fiduciary” arrangements
- Partial Outsourcing: Closer to the traditional investment consulting model, providing advice/co-management with plan’s in-house committees or investment staff.

Independent Fiduciaries

- Background: The independent fiduciary, in many respects, incorporated elements of 3(38) managers, 3(21) investment advice, and in some cases, plan administration – it's a hybrid concept – which shifts the responsibility in a conflict situation to a third party.
  - Independent fiduciaries, in effect, "outsource" the responsibility for a number of situations – specific transactions, ongoing monitoring, and even plan administration in certain contexts – where the plan fiduciary is otherwise conflicted or has limited to no expertise in evaluating a situation.
- Litigation Origins: Not specifically described in ERISA or ERISA's Conference Report – grew out of DOL enforcement and litigation activities involving plans.
  - Pre-ERISA: Blankenship v. Boyle (329 F. Supp. 1089, 1 EBC 1062 (D.D.C. 1971)) – District Court held that significant conflicts of interest and fiduciary breaches in the operation and administration of a multiemployer plan warranted the replacement of the existing trustees and the appointment of a new "independent" trustee.
  - Central States: A1977 DOL and Internal Revenue Service ("IRS") settlement with the Teamsters' Central States, Southeast and Southwest Areas Pension Fund (the "Teamsters Fund") required, among other things, the appointment of (1) an independent fiduciary to oversee the management of the Teamsters Fund's assets, (2) an independent investment manager to oversee certain Teamsters Fund assets, and (3) an independent special counsel to monitor the Teamsters Fund's compliance with the terms of the settlement.

Independent Fiduciaries (Cont.)

- <u>Development Through Prohibited Transaction Exemption Process</u>
  - Through the 1980s and 1990s the DOL, as part of its individual prohibited transaction exemption process, frequently required the retention of an independent party to review, and oversee, potentially conflicted transactions between the plan and (usually) the plan sponsor.
  - <u>ABA Report (1990)</u>: Three common criteria imposed by DOL: (i) a qualified and active independent be involved in the transaction," preferably at the outset of a proposed transaction "but certainly prior to" a plan's committing to the transaction, (ii) the independent fiduciary should be both "independent" of the parties in the transaction and have expertise in evaluating the type of transaction proposed, which would allow the DOL "to rely upon the independent fiduciary's . . . judgment"; (3) the independent fiduciary must make an explicit written recommendation or consent before proceeding, and depending on the circumstances ongoing monitoring of the transaction by the independent fiduciary."
  - Under the DOL's current PT Exemption Procedures, an independent fiduciary is defined as an "individual or entity with appropriate training, experience, and facilities" that is retained to act on behalf of a plan in connection with a transaction that is the subject of a prohibited transaction and, as determined by the DOL, is "independent of and unrelated to any party in interest engaging in the exemption transaction and its affiliates" 29 CFR 2570.31(j)
    - The DOL proposed a recent modification of this definition in the exemption context for independence to "generally" be satisfied if income received by the independent fiduciary from the parties is not more than 2% of the prior year's revenue (the old test presumed independence at that level), but the percentage may go up to 5% depending on the circumstances.

Traditional Services

Company Stock Funds –
DC Plan Ongoing and Sunsets

Litigation Settlements
(Securities and ERISA class actions)

Qualifying Employer Securities –
DB Plan Contributions and Management

Selection of Annuity Products
in Pension Risk Transfers

Qualifying Employer Real Property –
DB Plan Contributions and Management

Proxy Voting –
Corporate Transactions Involving ESOPs

Prohibited Transaction Exemptions

Discretionary Trustee Services
(ESOPs, Rabbi Trusts)

Emerging Applications

Health and Welfare Plans –
Use of Affiliated Service Providers

ERISA Audits –
Section 408(g) and QPAM Exemptions

"Orphan" Plans and Retiree Medical Funding Trusts

Conflicts Facing Financial Institutions (Brokerage, Cross Trading, VFCP Reviews)

Multiple Employer Plans and Pooled Employer Plans

Consent Determinations –
Alternative Investments

New Product Development –
Fiduciary Expertise

Affiliated Manager and Proprietary Investments

Outsourcing Plan Administrative Responsibilities

3(16) Outsourcing

- Third Party Administrator ("TPA") Role v. 3(16) "Outsourced" Administration
  - Standard of Conduct – fiduciary or not for a TPA?
- Potential Advantages of 3(16) Outsourcing
  - 3(16) administrator assumes fiduciary (as well as contractual) responsibility for referenced operational, transactional, and reporting functions of the plan
  - May create efficiencies around operations, reporting, and disclosures as all processes are streamlined within one entity, rather than potentially shared with the client
  - May reduce the burden on the employer/sponsor's employees by outsourcing in plan administration and process
  - May ultimately provide cost savings advantage to Sponsor by redirecting employee efforts to business (rather than plan) support
  - To the extent the arrangement provides third party with discretionary authority to pay claims without financial/structural conflicts the employer may have (for both retirement and welfare plans), may minimize or avoid "conflict of interest" decision making

3(16) Outsourcing vs. TPA Arrangements

- Some Issues to Consider in Reviewing 3(16) Outsourcing v. TPA Arrangements
  - Cost: Is there a cost differential in the service model, and/or is it born by the plan or the employer?
  - Monitoring: Is there a legal distinction/difference if the 3(16) administrator either is (a) actually named in the plan document, or (b) appointed under the procedure described in ERISA Section 402(a)(2) in the plan document by the employer or employee organization
    - Is this a "settlor" decision or a "fiduciary" one (with the employer retaining the duty to monitor?
    - What is the potential extent of co-fiduciary liability?
  - Liability for errors:
    - Who bears the primary financial responsibility?
    - What is the insurance/financial support in the event of an allegation of fiduciary breach by the 3(16) fiduciary v. potentially non-fiduciary directed decisions by a TPA?

Pooled Employer Plans

Pooled Employer Plan "PEP"

- A PEP is a new kind of retirement plan that enables employers of all sizes to join together for efficiency and cost savings. It's like a traditional 401(k) plan offered by individual employers, but with many additional advantages for a Plan Sponsor and participants.
- Benefits of a PEP
  - <u>Potential for lower costs</u>: costs can be spread across a larger participant and asset base, typically reducing the costs for each employer in the Plan. Participating Plans may also have access to more institutional priced investment options.
  - <u>Less fiduciary responsibility</u>: certain responsibilities are delegated to 3(38) and 3(16) service providers, helping to mitigate risk to the Plan Sponsor.
  - <u>Less time and effort</u>: The pooled plan provider "PPP" handles much of the administration, including eligibility, beneficiary tracking and plan disbursements

Comparison of a PEP vs. Traditional 401(k)

Responsibility	Pooled Plan Provider	Employer Advisor	Adopting Employer	SINGLE-EMPLOYER PLAN* Employer
Selects and monitors the pooled plan provider (PPP)			✓	N/A
Serves as 402(a) named fiduciary	✓			✓
Serves as 3(16) operational fiduciary	✓			✓
May select the 3(38) investment manager	✓		✓	✓
Consults on plan design	✓	✓		✓
Selects plan design provisions			✓	✓
Reviews, signs and files Form 5500	✓			✓
Reviews and signs off on compliance testing	✓			✓
Monitors plan eligibility	✓			✓
Handles beneficiary tracking	✓			✓
Prepares and approves required notices and reports	✓			✓
Reviews/approves/signs-off on all distributions	✓			✓
Reviews and approves all QDROs	✓			✓
Compiles and completes year-end census data			✓	✓
Submits timely and accurate payroll and plan contributions			✓	✓
Selects and works with plan auditors	✓			✓
Manages participant communications and education	✓	✓		✓
Conducts investment meetings		✓		

Based on standard PEP provisions and structure; division of responsibilities may vary

Other PEP Considerations

- Outsourced fiduciary services to limit employer risk:
  - 402(a) - named fiduciary
  - 3(16) - administrative fiduciary
  - 3(38) – investment manager
- Integrated trust and custody services
- Full range of digital participant solutions
- Full range of digital participant solutions
- Dedicated relationship manager for employer

Questions?

Speaker Biographies

Mr. Olstein is a partner in the New York office of Hogan Lovells US LLP. His practice focuses on the fiduciary responsibility provisions of ERISA and the prohibited transaction excise tax provisions of the Internal Revenue Code. He has an extensive background advising financial institutions, plan sponsors, and investment committees on ERISA matters, including compliance with ERISA's fiduciary duty and prohibited transaction rules in connection with the investment of pension plan assets. He also advises high net worth individuals in connection with the investment of IRA assets. Mr. Olstein has been recognized by Chambers USA as a leading ERISA attorney.

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Mr. Ryan is CEO, President, and Chief Fiduciary Officer of Newport Trust Company, LLC, an Ascensus Company, and served as President and Chief Fiduciary Officer of Evercore Trust Company, N.A., prior to the acquisition of Evercore Trust's institutional trustee and independent fiduciary business by Newport Trust in 2017. Prior to Evercore Trust, Mr. Ryan was with Morgan Stanley, where he was an Executive Director in the Legal and Compliance Division and Head of ERISA Law, responsible for coordinating ERISA and qualified tax issues for Morgan Stanley's Institutional Securities Group (Institutional Brokerage), Morgan Stanley Investment Management (Asset Management), and Morgan Stanley Smith Barney (Retail Brokerage).

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As Managing Partner and Head of Defined Contribution at Fiducient Advisors, Mr. Gardner services institutional clients by providing fiduciary governance oversight, plan design analysis and implementation, fee disclosure review, vendor search and selection, and investment analysis. He is a member of the firm's Defined Contribution Business Council as well as Chair of the Defined Contribution Strategic Oversight Committee. Mr. Gardner helped to establish Fiduciary Investment Advisors, LLC in 2006, which combined with Fiducient Advisors in 2020.

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