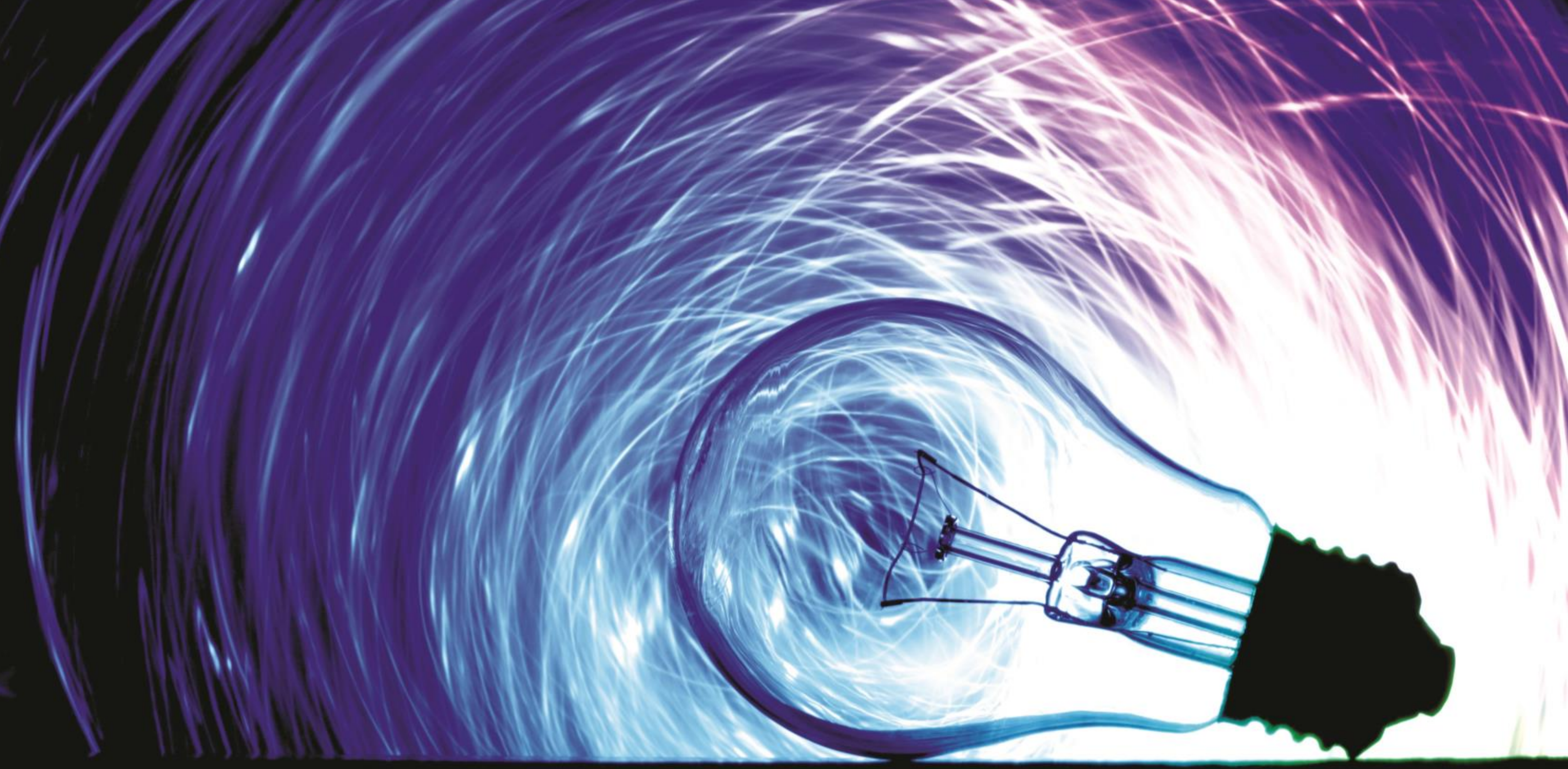

15 Misconceptions About The Three Principal Fiduciary Roles In A Retirement Plan

A WHITE PAPER BY

Pentegra Retirement Services
2 Enterprise Drive, Suite 408
Shelton, CT 06484-4694
800.872.3473 tel 203.925.0674 fax
www.pentegra.com

PENTEGRA

Confusion over the legal and practical nature of the named fiduciary, trustee, and administrator roles in ERISA retirement plans is common and understandable given the many ways a plan can be structured. Even experienced ERISA attorneys find themselves questioning which responsibilities go with which named fiduciary roles under which circumstances.

The problem lies in the practical application of retirement plan law. In the law, the definitions of "trustee," "administrator," and "named fiduciary" are clear; but the practical application of which duties belong to which person varies enormously based on individual plan document language. This article attempts to clear up some of the haze.

The Named Fiduciary

ERISA §402(a) says:

1. **Named fiduciaries**
    - A. Every employee benefit plan shall be established and maintained pursuant to a written instrument. Such instrument shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan.
    - B. For purposes of this subchapter, the term "named fiduciary" means a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary
        - a. by a person who is an employer or employee organization with respect to the plan or
        - b. by such an employer and such an employee organization acting jointly.

The key point is that only the employer can appoint a named fiduciary, and only through specific language in the plan document.

ERISA §402(b)(2) goes on to spell out how responsibilities are allocated among named fiduciaries:

1. Requisite features of plan Every employee benefit plan shall—
    - A. describe any procedure under the plan for the allocation of responsibilities for the operation and administration of the plan (including any procedure described in section 1105 (c)(1) of this title)…

Misconceptions About The Named Fiduciary

Misconception No. 1: “Named Fiduciary” Is A Specific Role
“Named fiduciary” is actually a non-specific role. Being named as “the” named fiduciary could mean anything. It is every bit as vague and general as the term “fiduciary” with one added bit of information—not only is the person a fiduciary, the person is named as such in the plan document or under a procedure specified in the plan document.

There is actually no objective reason a plan document must be drafted to name anyone as the “named fiduciary.” What is mandatory is that the plan document name at least one fiduciary. Virtually every document, as a practical matter, names two—the trustee and the administrator— because ERISA requires a plan to have both. To name a third “named fiduciary” is superfluous, and in point of fact one of the most-used documents in the industry, the Relius volume submitter, does not designate a separate “named fiduciary” anywhere in the adoption agreement—instead there is simply a mention in the basic document language stating that the administrator is also the named fiduciary for purposes of being the “go to” person for interested parties.

The evolution of this misconception is in how plan documents have historically been drafted and continue to be drafted. Many documents specifically identify a “named fiduciary” and the adoption agreement, unlike the Relius document, has a fill-in-the-blank spot for a person’s name to be inserted. (“Person” is used here in the legal sense, which can include an entity like a corporation or a human or “natural” person.) In nearly 100% of plans in existence today that bother naming a separate “named fiduciary” the plan sponsor is listed in this role. This begs the question—what is the “named fiduciary” in such a document actually responsible for? Short answer—not much. The trustee and administrator do all the work.

For ease of conversation when I use the term “named fiduciary” below to refer to a person identified separately by this title I will omit the quotes and in most cases I will use the term “principal” named fiduciary to describe the person whose name appears in the fill-in-the-blank on the adoption agreement for “named fiduciary.” Even this term is problematic, but it is important to distinguish “the fiduciary identified by the title ‘named fiduciary’ in the plan document” (quite a mouthful) from the generic use of “named fiduciary,” because both the trustee and administrator are also named fiduciaries.

Misconception No. 2: The Named Fiduciary is Responsible for Everything.
This would be true if the document said so. In point of fact the plan document virtually never says so. The document does not say, “The named fiduciary is responsible for operating the plan and appointing other fiduciaries, such as a trustee and administrator, to assist.” There would be nothing wrong with this language but the language is not there in the documents I have read. ERISA §402(a) says that the plan document must name one or more fiduciaries to run the plan; it does not say that the plan document must name a fiduciary whose job is to name the other fiduciaries. The document itself names the fiduciaries and the sponsor controls the document—the only fiduciary role of the sponsor, in other words, is to choose one or more named fiduciaries, via plan document language, and allocate duties among them.

Responsibility among named fiduciaries is "allocated." The use of the term "allocated" comes from ERISA §405(c) and DOL Reg. §§2509.75-5 and 75-8, which state that responsibilities can be *allocated* among named fiduciaries or *delegated* from a named fiduciary "to another fiduciary who is not a named fiduciary." The allocation is done in the plan document or under a procedure permitted under the language of the plan document. Think of it as the division of labor. The statutory division of labor can be summarized, roughly, as follows: the trustee is responsible for the assets, the administrator is responsible for everything else. This is a simplification but a reasonably accurate one.

Misconception No. 3: The Plan Sponsor Must be the overall Named Fiduciary.
Anyone can be a named fiduciary so long as they are not disqualified under ERISA §411, which prohibits felons, for example, from being ERISA fiduciaries. It is true that the buck stops with the employer since the employer appoints all named fiduciaries via the document, but it's not true that the employer needs to be responsible for anything other than this appointment.

Misconception No. 4: The Named Fiduciary Chooses the Service Providers.
This is one way to do it, but the structure of most plans (i.e., the documents) does not spell it out this way. In point of fact any of the three principal named fiduciaries under most documents can appoint service providers. The trustee can appoint an investment manager, and so can the named fiduciary who chooses the trustee (usually the employer). The administrator can choose a TPA or the named fiduciary can do it.

Misconception No. 5: The Named Fiduciary Appoints the Trustee and Administrator.
Again, this is only true if the document says it's true, or if the named fiduciary does in fact make these appointments pursuant to a procedure specified in the plan. The language matters. Why is this important? Because the world is changing and more and more vendors are offering expanded fiduciary services in a variety of shapes and flavors. Here's an example:

> An association, via its board of directors, chooses to sponsor a multiple employer plan (MEP). This is a business decision, not a fiduciary decision (a "settlor" decision). The board then makes the decision that the power to appoint fiduciaries will rest with a separate board or committee made up solely of five of the MEP's adopting employers, and that membership on this board will be determined thereafter by a voting process in the MEP bylaws. This committee chooses a firm to serve as the principal named fiduciary and as the administrator, and chooses a trust company to serve as discretionary trustee. As long as this method of appointing and allocating duties among named fiduciaries is consistent with the actual language of the plan document, it works.

Remember from ERISA §402(a) says only that the plan document must identify one or more named fiduciaries; it does not say that the plan must identify one named fiduciary who will appoint all others. A document could be written this way, but few actually are to my knowledge.

The Trustee

The assets of most ERISA plans are required to be held in trust:

(a) Benefit plan assets to be held in trust; authority of trustees
Except as provided in subsection (b) of this section, all assets of an employee benefit plan shall be held in trust by one or more trustees. Such trustee or trustees shall be either named in the trust instrument or in the plan instrument described in section 1102

(a) of this title or appointed by a person who is a named fiduciary, and upon acceptance of being named or appointed, **the trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan**…

The "owner" of the trust is the trustee, and the trustee's responsibilities may be understood as having two parts: safekeeping of assets and management of assets. A trustee who keeps full responsibility for management is referred to as a "discretionary" trustee to distinguish it from the more common "directed" trustee. A directed trustee is directed (with respect to investment management) by whoever appointed the trustee (generally the employer) under ERISA §403(a)(1).

Misconceptions About The Trustee

Misconception No. 6: There is no Problem with appointing an RIA or an Individual who is not Employed by the Sponsor as Trustee.

This is true under ERISA—just about anyone can be a trustee for ERISA purposes. The problem is that securities law and state law raise multiple issues to navigate for a non-bank trustee. I have known of individuals and firms serving as a professional trustee or administrator, with access to plan assets, and in most cases it raises concerns: giving control of big piles of money to unregulated individuals and entities is bad policy for a retirement plan. For example, many states have laws limiting the ability of non-bank entities to assume trust powers, and even when trust powers are permitted a variety of securities laws kick in (for example, being trustee may mean you have custody for SEC purposes, even if you have a custodian you use). And case law is unfortunately full of examples of malfeasance by unregulated fiduciaries.

It generally never occurs to employers to appoint an individual who is a non-employee as trustee, just as it never occurs to most advisors to attempt to offer trustee services, but I have seen examples of both, and they were fraught with peril.

Misconception No. 7: An Investment Manager Has the Same Responsibility as the Trustee.

As a practical matter an ERISA §3(38) investment manager can accept responsibility for virtually all investment functions, making it fairly close to the level of responsibility of a discretionary trustee, but the trustee role is different in four ways. The differences are not necessarily a big deal at a practical level, but they are worth pointing out.

First, all trustees, whether discretionary or directed, have residual duties that investment managers do not. For example, a trustee has an obligation to ensure it does not follow directions that are contrary to ERISA or the plan document. Trustees are also obligated to pursue contributions that are owed to the trust, such as untimely remissions of deferral contributions. And trustees must timely process participant directions in a participant-directed plan.

Second, the trustee duty can be described as "broad scope." The trustee, when discretionary, is responsible for everything having to do with the assets. An investment manager, no matter how broad its mandate, is by definition a more "limited scope" fiduciary in that its duties must be spelled out in writing, and are generally limited to those written duties.

Third, the use of a regulated financial institution as trustee may allow the plan to use a "limited scope audit," which is simpler and therefore cheaper, whereas the use of an investment manager does not affect the scope of the audit.

Finally, the trustee is responsible for safekeeping of assets, whereas an investment manager is not. Because of these last two reasons it may be sensible for a plan who hires an RIA as investment manager to employ a directed trustee: this covers most, if not all, of the bases. If there are any gaps it will be because of gaps in what the manager is responsible for (e.g., if the manager is only responsible for fund selection and the trustee is directed, the employer is still stuck with asset allocation and the need for ERISA §404(c) protection—a discretionary trustee cures that).

Pairing an investment manager with a directed trustee is nearly indistinguishable from having a discretionary trustee so long as the plan document and service agreements are drafted to grant the manager broad authority to invest the assets. The point is not that one arrangement is superior to another, but that the roles are different and therefore so are the document construction and due diligence.

Misconception No. 8: The Trustee is the Fiduciary with Overall Responsibility for the Plan.
Again, this is true only if the document says so, and the documents virtually never say so. The trustee is responsible for assets, and the administrator is responsible for everything else.

Retirement plan practitioners generally know that the trustee is not the "top" fiduciary, but employers often get confused about this, due in part to their familiarity with the use of "trustee" in a non-ERISA trust, in which the trustee's authority is generally absolute. Also Taft-Hartley plans (union plans) use the term "trustee" to describe an overarching authority, and this use of the term "trustee" (which predates ERISA) requires some careful document crafting to clarify the roles. For example, the term "investment trustee" might be used to describe the discretionary trustee role, and the term "trustee" is reserved for the Labor-Management board of trustees governing the plan.

The Administrator

Misconceptions about the Administrator

Misconception No. 9: The TPA or Recordkeeper is the Administrator.
Retirement plan professionals know better than this but clients do not. The administrator is a fiduciary named in the plan document: a TPA is a clerical or "ministerial" (non-fiduciary) assistant to the administrator.

Misconception No. 10: The Administrator is the "Top" Fiduciary in Charge of the Plan.
Again we have to look to the plan document: this can be true if the document language makes it true. And in point of fact there is at least one major provider whose documents are written this way: with the administrator named as the ultimate authority. Most documents, however, do not have the administrator in this role: instead the administrator is the partner to the trustee in running the plan, with the employer retaining the fiduciary power of appointment. An implication of the "administrator as king" document language is that the administrator appoints the trustee and any other fiduciaries or service providers. Again, this is only true if the document says so, and in most cases it does not.

Misconception No. 11: The Administrator Must be Separate from the TPA.
The theory here is that the administrator chooses the TPA but cannot be the TPA. This is false and is explained below under Misconception No. 13.

General Misconceptions About The Principal Fiduciary Roles

Misconception No. 12: "I don't Care what 'They' Say, You can't Delegate Fiduciary Liability."
This is an old favorite that continues to puzzle me when people trot it out. My best guess as to why it remains popular is that some practitioners believe their value proposition rests upon the notion that sponsors cannot shed their liability, so an advisor is needed to help manage it. This is unequivocally false (that sponsors cannot shed liability, not that sponsors need advisors, which they assuredly do). It is true that an employer cannot shed ALL responsibility and therefore liability, but to paint the issue with a broad brush using words that suggest no delegation is truly effective is tremendously misleading. This topic is covered extensively in my book, *401(k) Fiduciary Governance: An Advisor's Guide*[1], and the best references are ERISA §405(c) and DOL Interpretive Bulletins 75-5 and 75-8.
There are two key caveats to any fiduciary delegation: first, there must be prudent selection and monitoring. Second, the appointing fiduciary must avoid co-fiduciary liability, but a plain reading of ERISA §405(a), the co-fiduciary liability provisions, shows that this is quite easy. The only point of attack for an adventuresome plaintiff's lawyer hoping to get money from a plan sponsor who has outsourced fiduciary roles, therefore, would be to attack the prudence of the delegation since the sponsor is otherwise untouchable with respect to the acts and omissions of the hired fiduciary. So ask yourself: how many lawsuits do you know of in which an employer has suffered a loss due to a claim that they made an imprudent service provider selection? There have only been a handful of such cases, ever, so to suggest that this is a significant risk and that delegation is not effective is profoundly misleading.

Misconception No. 13: It's a Conflict of Interest to "Choose Yourself" to be the … (Fill in the Blank).
There is a new breed of service provider arising in the marketplace that positions itself as an added layer between the employer and other service providers. Contrast that business model with that of a discretionary trustee, which chooses the investments rather than choosing a person to choose the investments. Or contrast it with the business model of a "working" 3(16) administrator that not only accepts the fiduciary role but actually performs the administrative functions rather than hiring a TPA. Both business models can be extremely helpful to an employer and both are valid.

---

[1] Third Edition. Available through asppa.org.

The way this misconception is usually phrased is, “It’s a conflict of interest because they (a discretionary trustee) are choosing themselves to be the investment manager,” or “They (a professional 3(16) administrator) are choosing themselves to be the TPA.” If a firm were “choosing itself” in these circumstances then naturally there would be a conflict. But that’s not what’s going on.

The key is in who does the appointing. If an employer hires a firm to serve as the 3(16) administrator and that firm does its own administration instead of outsourcing to a TPA, the appointment is being made by the employer, not the administrator. The administrator is not appointing itself.

What would clearly be a conflict, on the other hand, is if the employer said to this firm, “Please help me choose a TPA” and the firm conducted a search, the result of which was choosing itself as TPA.

Misconception No. 14: It’s a Conflict to Serve as Both Trustee and Administrator.

This is similar to the previous Misconception. If it were true, there are a lot of companies who have appointed the company itself or the owner of the company to serve as trustee and administrator who are in conflict. I have met folks who are quite certain that this is true. The statute, again, is the best way to resolve this one:

ERISA Section 402(c) Optional features of plan

Any employee benefit plan may provide—

> (1) that any person or group of persons may serve in more than one fiduciary capacity with respect to the plan (including service both as trustee and administrator) …

Misconception No. 15: It’s a Conflict to Serve as an Investment Fiduciary at Both Plan and Participant Levels

Many times advisors have told me they thought it impermissible for a discretionary trustee of a plan to also advise participants or manage participant accounts, or for an investment advisor to recommend a fund menu and also advise participants on asset allocation. This is false. What is true is that a fiduciary must avoid conflicts of interest, such as non-level compensation, but the dual role itself is not a problem as ERISA Section 402(c)(1), above, makes clear. For example, a 3(38) manager of a plan may also advise participants or manage participant accounts so long as his or her compensation is level (e.g., the manager can’t make more money for steering participants into managed accounts).

How does One Learn More?

At the risk of crass commercialism, you could just buy my book. I’m trying to double my revenue from 2 cents per hour to 4 cents for the time I spent writing it. For those of you wondering when I’ll release a fourth edition, the answer is, “Whenever the DOL gets around to releasing the new fiduciary definition.”

Pete Swisher is the author of *401(k) Fiduciary Governance: An Advisor’s Guide*, and Senior Vice President of Pentegra Retirement Services, a retirement plan provider with a 75 year history as a professional fiduciary. He can be reached at pete.swisher@pentegra.com.

Follow us on