3(38) Advisory Services - Should Fiduciaries Outsource Retirement Plan Investment Responsibility?

Department of Labor (DOL) enforcement recoveries are on the rise. A recent DOL report indicates that DOL recoveries have doubled since 2018 and tripled since 2016 (https://www.investmentnews.com/dol-retirement-plan-recoveries-198660). As a result, fiduciary liability premiums have increased 35% since last year (https://www.investmentnews.com/fiduciary-insurance-costs-401k-litigation-198407).

Fiduciaries are personally responsible for participant losses resulting from a fiduciary breach. Plan sponsor fiduciaries who handle plan investments themselves, or use advisors who do not assume fiduciary status, face potential exposure for both investment performance and all plan fees.

The Employee Retirement Income Security Act of 1974 (ERISA) specifies that any plan fiduciary level decision must be informed by expertise. Most plans do not have a credentialed investment expert on committee (if they do, that individual is typically not amenable to accepting the responsibility and liability involved). Plan sponsors who are wont to mitigate this liability for investment decisions (investment menu structure, selecting and monitoring plan investment options) have specific options available under ERISA.

ERISA 3(21) Investment Advisor

The most utilized mitigation option and perhaps most suitable for many plans is hiring an ERISA 3(21) investment advisor. An advisor acting in a 3(21) capacity is responsible for delivering unbiased prudent investment recommendations regarding the selection, and ongoing monitoring of plan investments. The DOL has made clear that it is the responsibility of the plan investment fiduciaries that the final selection be commensurate with their participants' needs. Your advisor has access to a Qualified Default Investment Alternative (QDIA) selection tool. This tool is used to determine and document the participant demographic investment appropriateness for a QDIA, thus eligible for a fiduciary "QDIA safe harbor". This same tool can also aid in making an appropriateness determination for individual investments as well.

ERISA 3(38) Investment Advisor

Section 402 of ERISA allows plan fiduciaries to delegate investment responsibilities to, what ERISA calls, a "named fiduciary." This named fiduciary is a 3(38) investment advisor who assumes all responsibilities for selection, monitoring, and participant demographic appropriateness for plan investments. The company is then left with only monitoring that the advisor retains a prudent analytic process (e.g., their analytic process does not deteriorate substantially from its original prudent level). The 3(38) advisor needs to work with the client to determine investment appropriateness on issues such as risk, expense, and style appropriateness, but once accomplished, substantially more meeting time is available for other important topics like fiduciary education, plan success, participant retirement readiness, and more.