



Looking ahead

DOL opines on plan sponsor's diverse investment manager program

The Department of Labor (DOL) recently advised that a program under which Citigroup Inc. (Citi) subsidizes investment management fees for its employee benefit plans' diverse investment managers could be implemented without unfavorable consequences under the fiduciary and prohibited transaction provisions of ERISA. [Advisory Opinion 2023-01A](#), issued on September 29, 2023, provides plan sponsors with a potential pathway to support the use of diverse investment managers in a manner that is consistent with ERISA.

The Diverse Investment Manager Program

Citi established an Action for Racial Equity initiative in 2020 with a number of components intended to decrease the "racial wealth gap." One such component is the Racial Equity Program (Program), under which Citi will pay all, or some portion of, the investment management fees for "Diverse Managers" retained by Citi's own employee benefit plans. The Program defines Diverse Managers as managers that have a total minority/female ownership of a pre-determined percentage set forth in the Program, such as 50 percent, determined by reference to a third-party database.

The Program will be implemented by establishing a pre-determined aggregate amount that Citi will allocate to its employee benefit plans for a finite period of time, determined on a plan-by-plan basis. The Program is expected to place limits on the total amount available, the amount available to individual Diverse Managers, and the payment of incentive fees. Citi also expects that its commitment to pay for all or part of a Diverse Manager's fees will be set for a minimum of three years, which will be disclosed to the respective plan investment fiduciaries for their consideration.

The investment fiduciaries for each employee benefit plan eligible for the Program will select investment managers using typical factors such as the candidates' credentials, years in business, asset class experience, and other general factors the fiduciaries deem relevant and aligned with ERISA. Investment management fees are among the factors considered, taking into account any Program commitment to pay the fees if applicable. Citi will not attempt to influence the investment fiduciaries' selection process, and the fiduciaries will not have numerical targets or similar requirements regarding the selection of Diverse Managers. Investment managers that are parties-in-interest due to affiliation with Citi will not be eligible for the Program, which addresses potential ERISA prohibited transaction concerns.

DOL Opinion

The DOL opined on three general issues in connection with the Program.

(1) Citi's establishment of the Program is not a fiduciary activity

The DOL will not view Citi as a fiduciary for investment manager selection merely as a result of establishing the Program and paying or reimbursing Diverse Manager fees. The DOL noted that "[p]lan sponsor decisions on plan document provisions governing whether and under what circumstances the sponsor will pay fees and expenses that could otherwise appropriately be paid by the Plan are settlor decisions not subject to ERISA fiduciary standards."

The DOL stated that Citi retains fiduciary obligations with respect to the selection and monitoring of investment fiduciaries. Citi indicates that it will not select investment fiduciaries on the basis of their use of the Program, and, because this point is inherently factual in nature, the DOL stated that it will not opine on whether Citi's actions in this regard are consistent with ERISA.

ESsentials: Under the Program, Citi plays no role in identifying specific investment managers that will be eligible for the Program; the Program simply sets out eligibility criteria that an investment manager must satisfy in order for its fees to be subsidized. Other variations in which a plan sponsor might identify specific investment managers that would be eligible for a management fee subsidy, or a scenario in which an investment fiduciary first identifies several investment manager finalists and then asks the plan sponsor to select the manager or managers for which it will reimburse fees, could produce different results on the question of whether the plan sponsor is engaging in fiduciary activity.

(2) The investment fiduciaries can take the Program into account without violating ERISA

The DOL concluded that the investment fiduciaries may take into account Program subsidies in assessing various investment managers without violating ERISA section 403 (the exclusive purpose rule) or section 404 (the fiduciary prudence rule). The DOL explained that the fiduciaries will not violate ERISA "solely by virtue of considering as one factor in the selection process that an investment manager's fees otherwise payable by the Plan will be reduced or paid in full by Citi under the program." The DOL noted that fiduciaries should consider all relevant factors, including "the service provider's qualifications, the quality of the services offered, and the reasonableness of the fees in light of the services provided."

Furthermore, the DOL found that the Program does not give rise to a prohibited transaction under ERISA section 406(b)(2) as a result of the investment fiduciaries being aware that Citi may gain reputational benefits as a result of the Program. The DOL cautioned, however, that the investment fiduciaries may not make decisions on the basis of any benefits to or interests of Citi.

ESsentials: Some investment fiduciaries may already take into account the potential financial benefits to the plan resulting from an investment manager's diversity. The DOL noted that the Advisory Opinion should not be interpreted as providing the only path to selecting a diverse investment manager or as suggesting that diversity, equity, and inclusion factors cannot be independently considered from a financial perspective.

(3) Participant fee disclosure may include information about the Program

The Advisory Opinion stated that for defined contribution plans that require ERISA section 404(a)(5) annual fee disclosure, the disclosure will reflect the gross annual investment management expenses for all funds, including those for which fees are subsidized under the Program. The disclosure will also refer to the Program and the payment or reimbursement of investment management fees that results in a lower net operating expense.

The DOL opined that this approach is permitted under the fee disclosure regulations at 29 CFR 2550.404a-5(d)(2)(ii), which allow additional information to be provided if appropriate and not misleading. The DOL further concluded that the disclosure of the Program's existence and payments under the Program would not result in "improper influence" by the investment fiduciaries or Citi for purposes of ERISA section 404(c), which requires that participants be able to select investments free from undue pressure.

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed or the Eversheds Sutherland attorney with whom you regularly work.

Adam B. Cohen

Partner

[Email](mailto:adam.cohen@eversheds-sutherland.com) | +1 202 383 0167

Brittany Edwards-Franklin

Counsel

[Email](mailto:brittany.edwards-franklin@eversheds-sutherland.com) | +1 404 853 8130

Offi E. Ekah*

[Email](mailto:offi.ekah@eversheds-sutherland.com) | +1 202 383 0154

*Offi E. Ekah, also with Eversheds Sutherland (US) LLP in Washington DC, is not yet admitted to practice in Washington DC.

[eversheds-sutherland.com](https://www.eversheds-sutherland.com)

© Eversheds Sutherland Ltd. 2023. All rights are reserved to their respective owners. Eversheds Sutherland (International) LLP and Eversheds Sutherland (US) LLP are part of a global legal practice, operating through various separate and distinct legal entities, under Eversheds Sutherland. For a full description of the structure and a list of offices, please visit [eversheds-sutherland.com](https://www.eversheds-sutherland.com). US34152_101723