What You Need To Avoid In Hiring Providers As 401(k) Fiduciaries

By Ary Rosenbaum, Esq.

A plan sponsor has so many things to do in running a business that they often forget that as a 401(k) plan sponsor, they are also a plan fiduciary. Being a plan fiduciary requires the highest duty of care in equity and law. So to eliminate some of the burdens, a plan sponsor may want to hire a plan provider that will lessen the burden by serving in a fiduciary capacity. This article is all about the things to avoid when considering hiring plan providers as plan fiduciaries.

The buck stops with the plan sponsor, but it's nice to spread the risk of liability

In my family, I was Patient Zero when it came time to spreading illnesses because I apparently felt the need to share. When it came to Chicken Pox and Lice, I was the kid to bring it home. As a plan sponsor, the buck stops with them in terms of liability issues if things go wrong especially when dealing with plan providers who don't serve in a fiduciary capacity. Even if the plan provider serves in a fiduciary capacity, the plan sponsor is still responsible for hiring them. Even joining a Pooled Employer Plan, which is supposed to eliminate fiduciary liability for adopting employers still requires them to vet the Pooled Plan Provider that assumes the fiduciary liability. However, hiring plan providers as plan fiduciaries is good for spreading liability around. A plan sponsor can't fully eliminate the liability of being a plan fiduciary, they can only minimize it. A good way to minimize it is to spread the liability with plan providers who serve as plan fiduciaries.

The old rule was from 1976 and we are still trying to fix it

47 years ago, the DOL issued guidance defining who was a fiduciary under ERISA. The original definition included a five-part test that had to be satisfied in its entirety. The fiduciary rule was drafted at a time when the predominant retirement plan was a defined benefit plan whose assets were professionally managed by professional managers. A 401(k) plan where participants could direct their own investments by selecting mutual funds was years away. So the rule didn't anticipate the role of stockbrokers in the retirement plan business or the different levels of compensation they could earn by pushing specific plan investments. Since stockbrokers were the predominant financial advisor in the retirement plan space, there was concern that there was an inherent conflict of interest in the recommendations of investments they would offer if they received greater compensation on certain investments. So for the past 8 years and with the strong opposition of brokerage firms, the Department of Labor has issued and withdrawn new fiduciary rules and promises some more changes for 2023. Rather than bore you with the details of what the current rule is now, which is still subject to change, keep in mind that any fiduciary relationship you have with outside fiduciaries, needs to be consistent with the fiduciary rule that is in place, at all times.

The TPA isn't a fiduciary unless...

One of the biggest misconceptions out there is assuming that the third-party administrator (TPA) is a fiduciary. While in their role, they may be involved in the day-to-day trading involved with a participant-directed 401(k) plan, they will not be considered fiduciary unless they affirmatively take that role on. While there are many instances that a TPA crosses close or over the boundary on what may make a provider a fiduciary, a TPA who disclaims any role as a fiduciary would only be considered one after successful litigation. Quite honestly, in most lawsuits where the plan sponsor tried to claim the TPA is a fiduciary, they often lose. Again, a TPA isn't a fiduciary unless they take that role on if they identify that they or an affiliate of theirs will serve in a role as an ERISA §3(16) administrator. An ERISA §3(16) contractually takes on the role of the named plan administrator in the day-to-day plan administration. They will file Form 5500 and handle other administration tasks that the plan sponsor handles in the housekeeping parts of the plan.

A fiduciary warranty isn't worth the paper it's written on

Retirement plan providers are very good at selling something and there is nothing better out there than plan providers that tout a fiduciary warranty that they are giving away for free. A fiduciary warranty doesn't make the plan provider a fiduciary to the plan, which is confusing since the fiduciary word is there. The fiduciary warranty is merely a promise for a plan provider to indemnify a plan sponsor if they are sued in a very limited circumstance, namely that the investments offered in the plan don't satisfy the broad range investment requirement of a participant-directed investment plan under ERISA §404(c). There are many ways that a 401(k) plan can get sued and the broad range requirement isn't one of them because to steal a line from Montgomery Scott in Star Trek III, a monkey, and two trainees can pick mutual funds to satisfy the broad range requirement. The plan providers that offer the fiduciary warranty are usually insurance companies whose main block of business is insuring the risk. So the question is how much liability risk is there if the insurance company is giving a fiduciary warranty away for free? A fiduciary warranty doesn't make a provider a fiduciary, it's just a cute sales gimmick that offers the plan sponsor close to zero protection.

The devil is in the details

Anytime your contract with a plan provider, you need to review the terms of the contract to ensure what fiduciary role, if any, the plan provider will serve. The devil is in the details and in the contract because there have been issues in the past where the providers promise what they'll do but their contract says it differently. I have seen registered investment advisors who have always served in a fiduciary role by law try to claim that they're not. I've seen ERISA §3(16) administrators who won't file Form 5500 for their clients even though that's one of the main roles of a §3(16) administrator. I once knew a producing TPA with its own registered investment advisory firm, that claimed no fiduciary liability, which is akin to a doctor claiming they're not giving medical advice. Empty verbal promises won't hold up in a court of law as much as a written contract between the plan sponsor and the plan provider. Whatever is promised by a plan provider that will be serving in a fiduciary capacity should be in written form. Have every contract with a plan provider reviewed by an ERISA attorney so there are no surprises when things go south.

Delineate the roles of different plan fiduciaries

In baseball, when a pop fly is hit, there usually is someone in the field that will call for the ball and wave off the other fielders. If a plan sponsor happens to be in a situation where there are multiple plan providers in fiduciary roles, it's important to understand what fiduciary roles they serve and what their limitations are. Clint Eastwood as Dirty Harry in Magnum Force said: "A good man always knows his limitations." When you're dealing with plan providers as fiduciaries, you need to know what their role is and what they will not do. For example, a financial advisor serving in a fiduciary capacity or as an ERISA §3(21) or §3(38) fiduciary isn't going to have any role or responsibility in the day-to-day administration of the plan unless they affirmatively accept that reason as part of a greater fiduciary service package. An ERISA §3(16) administrator isn't going to take responsibility or liability for the fiduciary component of the plan unless the §3(16) administrator is also taking on the role of a financial advisor of the plan. When a plan sponsor has multiple fiduciaries assisting them, it's important where that fiduciary starts and where it ends.

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