How You Can Delegate Your Fiduciary Liability As A 401(k) Plan Sponsor

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Running a business is a complicated activity. You have to be an expert in your field, service, or specialty. To get your work done, there is a point where you will need to outsource some key employer functions such as payroll and other human resource functions. So it stands to reason that it may be wise to cut back on the headaches and outsource your retirement plan. The concern that plan sponsors should understand is that when it comes to their 401(k) plan, there is a difference between outsourcing and delegation. So this article is going to make 401(k) plan sponsors like you understand what outsourcing your plan entails and the traps you should avoid.

The usual model of delegation

As a plan sponsor, you're a plan fiduciary, and being a fiduciary requires the highest standard of care in equity and law. So while you have the responsibility to run your plan, there are two major problems. The first problem is that unless you are in the retirement plan industry you will have to delegate the administration of your plan to third-party providers. The second problem is that by delegating the administration of your plan to a third-party administrator (TPA) or financial advisor, you haven't delegated your responsibility. So by hiring a regular TPA and/or financial advisor, you are ultimately responsible for their work. So if your TPA has as much administration background as my 14-year-old daughter or your advisor is the second coming of Bernie Madoff, you are still at fault. So you can delegate some of your administrative duties in this arrangement, you are still on the hook for liability if your third-party providers are incompetent or crooked. With the increase in litigation against retirement plan sponsors, there is a need by many plan sponsors who want to eliminate as much as possible their fiduciary liability of running a retirement plan. So that need is met by an outsourcing solution, which can be handled by other providers who must designate their role as plan fiduciaries in order for you to divest yourself of most of that fiduciary responsibility.

Outsourcing fiduciary functions

The method of outsourcing your fiduciary responsibility isn't new. The fiduciaries who will offer these types of outsourcing services have a special designation to their service and you need to know the differences between the levels of services and to make sure that you are buying what you think you are buying and that you are getting the level of protection that you think you are getting because there are enough people in the retirement plan industry who will sell you a nickel and tell you it's a dime. It should be noted that with this outsourcing model, you could eliminate almost all of your liability when it comes to your plan's administration and investments. I said almost all because hiring these providers is a fiduciary function, so if one of these fiduciaries is incompetent, you're still potentially on the hook for some liability for hiring that incompetent fiduciary. Outsourcing isn't the solution for everybody because it requires a surrender of control and many plan sponsors like you want to control their plan's direction. However, it should be noted that you can outsource on an a la carte basis, you can outsource your investment control, but keep the responsibility of plan administration in-house or vice-versa.

ERISA §3(16) administrator

The TPA you hire is responsible for your plan's compliance, record-keeping, and tax filing. You may have two companies do the task such as a separate TPA and record-keeper, but it's the same tasks being completed by a tandem. Notice that a TPA is a third party, which means that you as a plan sponsor are ultimately responsible for any errors or issues dealing with the day-to-day administration of your Plan. If the TPA fails to file Form 5500 guess who is responsible for cleaning up the mess or paying those huge penalties? You, the plan's sponsor. So if you want to delegate that administration responsibility, what do you do? You hire an ERISA §3(16) administrator. So what's the big deal? The "Plan Administrator" of a qualified retirement plan is defined in section 3(16) of ERISA. The Plan Administrator should is not the same as a "Third Party Administrator" because a Section 3(16) administrator is a "first party" administrator. The Plan Administrator has the job of ensuring that all filings with the federal government (form 5500, etc.) are timely made; make the required and important disclosures to plan participants; hire plan service providers if no other fiduciary has that responsibility, and fulfilling other responsibilities as outlined in plan documents and their contract. The ERISA §3(16) administrator is a plan fiduciary and assumes the liability that comes with it. However, they have no direction in selecting the plan investments. When it comes to hiring a §3(16) administrator, a contract with any of these potential providers should be fully reviewed to delineate which task they will assume and which tasks you will assume. For example, a §3(16) administrator may or may not take on the task of making sure that 401(k) salary deferrals from employees are remitted on a timely basis. Needless to say, that is an extremely important task and you need to be sure which tasks this fiduciary will assume and take off your plate.

ERISA §3(38) Fiduciary

An ERISA §3(38) fiduciary is the ERISA defined "Investment Manager", which is defined in Section 3(38) of ERISA. The Investment Manager becomes "solely" responsible for the selection; monitoring and replacement of plan investment options, as well as all aspects of the fiduciary process such as developing the IPS and offering participant education. So in this structure, the Plan Sponsor and other plan fiduciaries are relieved of the responsibil¬ity for the Investment Manager's decisions. However, the plan sponsor retains a residual duty to prudently select the Investment Manager and make sure they are carrying out their appointed duties. Also the §3(38) fiduciary has no responsibility in dealing with the plan's administration. So while a §3(38) fiduciary is the Cadillac of investment fiduciaries, they are the Yugo of fiduciaries when it comes to the day-to-day running of the Plan. You should always review a contract from any potential §3(38) fiduciary, but it should be noted that there really is no such thing as a "limited scope" ERISA §3(38) fiduciary because all ERISA defined investment managers have full discretionary authority over the fiduciary process.

Full Scope ERISA §(3)(21) Fiduciary

An ERISA §(3)(21) fiduciary is basically a financial advisor who takes on the role of a fiduciary, as defined in ERISA §(3)(21). There are two types of a 3(21) fiduciary, limited scope vs. full scope. A limited scope §(3)(21) fiduciary will not help you with outsourcing your fiduciary responsibility While these advisors take all of the liability of being an ERISA §(3)(21) fiduciary, they have no discretion in selecting plan investments and handling the fiduciary process, you as the plan sponsor still has the final say and the liability to go with it. That means that despite all the code sections, plan sponsors will still be held liable for any breach of fiduciary duty in the fiduciary process such as the development of an investment policy statement (IPS), review of investment options, and participant education. A full scope ERISA §3(21) fiduciary can help with outsourcing your fiduciary responsibility. A full scope ERISA §3(21) takes on the role of the Named Fiduciary and has complete discretion and effectively assumes responsibility for the management and operation of the plan. That would include all investment management decisions unless an ERISA §3(38) fiduciary or a limited scope ERISA §3(21) fiduciary has been appointed. The Full Scope §3(21) Named Fiduciary is responsible for hiring, monitoring, and replacing all other service providers. So if a full scope ERISA §(3)(21) fiduciary is appointed by a plan sponsor, the only responsibility the plan sponsor retains is the proper selection and monitoring of that full scope/ Named Fiduciary. Since a Full Scope §3(21) fiduciary is a marketing concept and most financial advisors serve in a limited scope role, you must review contracts with these types of providers to make sure you are getting the level of liability protection you expect to be getting.

Pooled Employer Plan (PEP)

Starting in 2021, the Internal Revenue Code allows a new Multiple Employer Plan (MEP) called a Pooled Employer Plan (PEP). MEPs have been around as long as retirement plans are around, but in 2012, the Department of Labor required commonality among companies that adopted the MEP to be considered a single plan for ERISA purposes. The PEP eliminates that commonality requirement and essentially eliminates the fiduciary liability for a company that becomes part of a PEP as that role belongs to a Pooled Plan Provider. MEPs were never clear as to the extent of the liability of an adopting employer, but a PEP is pretty clear as to the elimination of fiduciary liability for a company that adopts one. However, choosing a PEP and a pooled plan provider is a liability that an adopting employer can't shed. As a single employer plan sponsor, joining a PEP may not be ideal if it doesn't offer the cost savings that should go with adding your plan assets with the other assets of other companies. PEPs may be a great way to eliminate fiduciary liability because you wouldn't be responsible for the day to day administration of the plan or filing a Form 5500, but there may be no cost savings if the PEP isn't big enough, which is supposed to be one of the attractions of joining a PEP.

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