

Prepared by the Law Offices of Geoffrey M. Strunk, LLC

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# HIRING AN INVESTMENT MANAGER

## ERISA Fiduciary Decision Making

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All investments involve risk, including possible loss of principal.

**IMPORTANT NOTE:** The Law Offices of Geoffrey M. Strunk, LLC have prepared this white paper on behalf of Franklin Templeton, Inc. This paper includes suggested practices that plan sponsors, and the financial professionals who work with plan sponsors, may wish to consider in connection with the management of the plan and its investments and the retention of investment professionals to assist in the management of plan assets.

It is important to note that the suggested practices are not the exclusive means of fulfilling fiduciary obligations with respect to the retention of investment professionals to assist in the management of plan assets. Other combinations of practices also may be effective. Plan sponsors and other fiduciaries should consult with their own legal counsel concerning their responsibilities under ERISA in the administration and management of their respective plans.

Future legislative or regulatory developments may significantly impact these suggested practices and the related matters discussed in this paper. Please be sure to consult with your own legal counsel concerning the application of ERISA to the selection and retention of investment professionals and your other fiduciary obligations under ERISA.

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**The content of this whitepaper was updated in January 2019 and is subject to change.**

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# INTRODUCTION

When a company makes the decision to sponsor a tax-qualified retirement plan, it subjects the company, its owners and some of its employees to the responsibilities and duties imposed upon retirement plan fiduciaries under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). One such ERISA fiduciary responsibility is to act as a prudent expert when discharging each ERISA imposed duty.<sup>1</sup> When Congress created ERISA, it knew that most businesses would not possess the expertise necessary to satisfy this ERISA obligation “in house.” Consequently, what Congress really created in connection with this ERISA obligation is a duty to delegate certain ERISA responsibilities to qualified professional experts.

There are few areas where a need to delegate ERISA fiduciary responsibility is more evident than in connection with retirement plan investments. Although many successful executives and business owners may also fancy themselves to be informed and qualified investors, amateur investment success does not equate to the statutory and regulatory expectations associated with an expert ERISA investment fiduciary. Why? Because an amateur investor is not likely to demonstrate the proper dedication to the time, research and, most importantly, process necessary to satisfy this ERISA obligation.

The following takes a pragmatic approach toward examining the delegation of ERISA fiduciary retirement plan investment obligations to an investment professional, which is itself a fiduciary act. In this regard, this document examines the benefits and limitations of delegating ERISA fiduciary responsibility, as well as the different types of ERISA investment professionals a plan sponsor might retain to provide this fiduciary level of service. Finally, consideration is given to when a recommendation or introduction of a financial professional by a third party might result in fiduciary status for the party making the recommendation or introduction.



# OUTSOURCING DISCRETIONARY RETIREMENT PLAN INVESTMENT DECISION MAKING

Before we begin to consider the process associated with delegating fiduciary investment responsibilities to an independent third party, it is important to understand that it is not possible to delegate all fiduciary investment responsibilities to a third party.<sup>2</sup> In this regard, different types of fiduciary investment professionals accept and absorb varying degrees of fiduciary responsibility and, more importantly, associated fiduciary liability from a plan sponsor. Indeed, one type of fiduciary investment professional can accept most of the ERISA fiduciary investment responsibility that would otherwise be retained by the plan sponsor. However, again, it simply is not possible to delegate away all fiduciary investment responsibility — even when employing the most comprehensive level of fiduciary provider — due to an ongoing fiduciary duty to monitor such providers.

By no means is this fact intended to suggest that a plan sponsor should not engage a fiduciary investment professional. Instead, these words of caution are only provided in order to reinforce that it is unavoidable for a retirement plan sponsor to accept some level of fiduciary responsibility and potential liability when adopting an ERISA retirement plan.

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<sup>2</sup> See ERISA §§ 402(a)(2), (c)(3); 405(c).

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## Why delegate fiduciary investment decision making?

There are three primary reasons for a retirement plan sponsor to employ a fiduciary investment professional. First, as explained above, an ERISA plan fiduciary is obligated to discharge his or her duties in accordance with an expert level of understanding and care.<sup>3</sup> However, most companies that sponsor a retirement plan are neither owned by nor employ individuals with the necessary level of qualifications to satisfy this requirement. In this context, an “expert” should be someone that a court would certify as such based upon his or her education and experience in association with investing and the financial markets. Consequently, although many individuals associated with a plan sponsor might like to think of themselves as successful investors, that is very different than being an expert investor. In our litigious society filled with multimillion-dollar damage awards being levied against ERISA fiduciaries due to their investment-related decision making, hubris can be an unforgivable sin. Thus, delegation of investment-related decision making to a qualified investment professional can help protect decision makers at the plan sponsor by satisfying the level of expertise that is demanded of an ERISA fiduciary in this context.

The second and perhaps most important reason to employ a fiduciary investment professional is to help insulate decision makers at the plan sponsor from potential liability. Despite the words of caution expressed earlier in this document regarding the limits that exist in connection with the delegation of ERISA fiduciary investment discretion to third parties, it is possible to effectively delegate varying levels of fiduciary responsibility to a third party.<sup>4</sup> Fortunately, what can be included with the fiduciary duties and responsibilities that are effectively delegated to such a third party are the associated potential liabilities. Obviously, it is incredibly important to carefully review the terms and conditions of a contract that attempts to delegate these types of responsibilities in order to ensure that the relationship and results of such agreement are fully understood and accomplish that which was intended. However, insulation from potential liability associated with an issue or topic that one does not necessarily fully understand is a desirable goal and an excellent result when it can be obtained.

The third and final primary reason to employ a fiduciary investment professional is to gain the efficiencies associated with delegating fiduciary investment responsibilities to a person or entity who routinely handles these matters and is intimately familiar with them. This allows the plan sponsor to leverage the expertise and familiarity with investment matters possessed by a financial professional while concurrently permitting the plan sponsor to remain focused on the tasks and responsibilities imposed by the operation of the plan sponsor’s day-to-day business operations.

For example, a qualified fiduciary investment professional should be able to readily assist with the establishment of a certified process for handling retirement plan investment decision making. This would include steps such as establishing or revising an Investment Policy Statement (“IPS”). An IPS is incredibly important as it is used to memorialize the rules by which investment decisions are made, including but not limited to the selection or replacement of investments, investment advisors and/or Investment Managers. As will be discussed further below, when it comes to protecting an ERISA fiduciary from potential liability, it is the process by which decisions are made that will ultimately determine whether a fiduciary duty was satisfied or not.<sup>5</sup> Therefore, the guidance provided by an experienced professional in connection with establishing the proper, prudent process for investment-related decision making is critical to insulating a fiduciary from potential liability in this context.

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<sup>3</sup> ERISA § 404(a)(1)(B).

<sup>4</sup> ERISA §§ 402(a)(2), (c)(3); 405(c).

<sup>5</sup> *White v. Chevron*, Case No. 16-cv-0793-PJH (N.D. Cal. Aug. 29, 2016); quoting *Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983); *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346 (4th Cir. 2014) quoting *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 420 (4th Cir. 2007); see also *Pension Benefit Guar. Corp. ex rel. St. Vincent v. Morgan Stanley Inv. Mgmt.*, 712 F.3d 705, 716 (2nd Cir. 2013).

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## To whom should fiduciary investment decision making be delegated?

In general, there are two types of third-party ERISA fiduciary investment service providers available to a plan sponsor. One is an “Investment Manager” as such term is defined under section 3(38) of ERISA and the related Labor regulations (“Investment Manager”) and the other is an “Investment Advisor” as such term is considered under section 3(21) of ERISA and related regulations (“Investment Manager”). This section of this document will define and explain the differences between these two types of third-party fiduciary investment professionals.

The first type of third-party fiduciary investment professional to consider is the Investment Manager. The primary distinguishing characteristic of an Investment Manager is that an Investment Manager generally exercises actual discretion with regard to the management, acquisition or disposal of plan assets.<sup>6</sup> Thus, in the context of an Investment Manager, the individual or group at the plan sponsor who would otherwise make discretionary investment decisions (usually a plan investment committee or, at times, an officer or director of the plan sponsor) (otherwise known as the “Responsible Plan Fiduciary”) no longer exercises discretion with respect to the selection of specific plan investments that might be made available to plan participants.<sup>7,8</sup> Instead, the Responsible Plan Fiduciary is only exercising discretion with regard to the selection, monitoring and review of the Investment Manager itself.<sup>9</sup>

A Responsible Plan Fiduciary is liable for the discretionary decisions it makes in the process of discharging its fiduciary responsibilities.<sup>10</sup> By employing an Investment Manager, the Responsible Plan Fiduciary reduces the discretionary decisions it must make as it fulfills its fiduciary obligations. This is because the Responsible Plan Fiduciary has effectively delegated its decision-making authority on this issue to the Investment Manager.

The second type of third-party fiduciary investment professional we will consider is the Investment Advisor. An Investment Advisor is a type of ERISA fiduciary who renders investment advice in exchange for a direct or indirect fee.<sup>11</sup> An Investment Advisor does not have the ability to exercise discretion to select the specific investments that are ultimately offered to participants.<sup>12</sup> Instead, the Investment Advisor makes investment recommendations to the Responsible Plan Fiduciary who has the ultimate discretion to decide whether or not to implement such recommendations.<sup>13</sup>

Generally, as compared to not using any fiduciary-level financial services professional, a Responsible Plan Fiduciary’s utilization of an Investment Advisor reduces the Responsible Plan Fiduciary’s overall fiduciary liability in connection with the selection of specific plan investments. This is because the Responsible Plan Fiduciary is receiving advice, that is fiduciary in nature, from an independent and professional third party. Such advice presumably serves as the basis for the investment selection discretion exercised by the Responsible Plan Fiduciary. Therefore, although the Responsible Plan Fiduciary serves as the final arbiter regarding the available investment options of a plan, the influence of the Investment Advisor may also be questioned and challenged in the event a breach of fiduciary duty is perceived to occur in association with the investment selection process.

The differences between the responsibilities of an Investment Manager and those of an Investment Advisor are significant. As described above, the delegation of fiduciary investment discretion to an Investment Manager is a much broader and more complete delegation of authority.<sup>14</sup> This is because an Investment Manager accepts and exercises full discretionary investment decision-making authority whereas an Investment Advisor is making only recommendations that may ultimately be accepted or rejected by the Responsible Plan Fiduciary. As a result of the more robust delegation of authority to an Investment Manager, a Responsible Plan Fiduciary who utilizes an Investment Manager would have fewer ERISA fiduciary investment responsibilities and, as such, would have a corresponding reduction in his or her fiduciary liability exposure than a Responsible Plan Fiduciary who utilizes an Investment Advisor.<sup>15</sup>

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<sup>6</sup> ERISA § 3(38).

<sup>7</sup> Although an Investment Manager is legally obligated to acknowledge its fiduciary status in writing, the specific roles and responsibilities of an Investment Manager may vary based upon the terms of the contractual agreement established between itself and its client. Therefore, it is strongly advised that the specific agreement proposed between the plan sponsor and its Investment Manager be carefully reviewed in order to ensure that the plan sponsor is aware of exactly which fiduciary responsibilities it is delegating to its Investment Manager and to what extent.

<sup>8</sup> See *id.*

<sup>9</sup> *Id.*

<sup>10</sup> See ERISA §§ 404(a)(1)(A), 409.

<sup>11</sup> ERISA § 3(21)(A)(ii); Labor Reg. §§ 2510.3-21(c) (1975); 2510.3-21 (2016).

<sup>12</sup> See *id.*

<sup>13</sup> *Id.*

<sup>14</sup> See ERISA §§ 3(38); 3(21)(A)(ii).

<sup>15</sup> *Id.*

Notwithstanding the distinct advantage of an Investment Manager over an Investment Advisor when it comes to insulation from potential liability, there are some plan sponsors who balk at hiring an Investment Manager. Some Responsible Plan Fiduciaries cite the resulting lack of control over plan investments as the reason for not employing an Investment Manager. Although not uniformly, I have seen this arise as a result of a desire on the part of a Responsible Plan Fiduciary to more effectively control his or her individual account within the plan. Unfortunately, this reasoning runs counter to what should be the controlling principle for every discretionary decision made by a Responsible Plan Fiduciary: the fulfillment of the fiduciary duty to operate the plan for the exclusive benefit of its participants and beneficiaries.<sup>16</sup> Thus, when this issue arises, careful counsel is advised regarding fiduciary roles and responsibilities in order to attempt to divine the motivation for the aversion to losing direct control over plan investments so that it can be ensured that the motivation is a permissible one.

Another issue to consider when deciding whether to retain an Investment Manager or an Investment Advisor is the cost associated with each service provider. An Investment Manager may charge a greater fee for its services than an Investment Advisor. However, as explained above, the services provided by an Investment Manager are much more significant than those offered by an Investment Advisor with respect to both the actual services provided as well as the insulation from liability obtained by the plan sponsor. Thus, generally it is not difficult to substantiate the value gained by incurring the higher fee.

One of the primary concerns that any attorney has when representing a client is to protect that client to the greatest degree possible from potential liability. In this context, if all other facts were identical, one would generally expect a Responsible Plan Fiduciary who utilizes an Investment Manager to have less fiduciary exposure than a Responsible Plan Fiduciary who utilizes an Investment Advisor. Thus, although a gross generalization, often an Investment Manager is better suited to satisfying the needs of a plan sponsor and Responsible Plan Fiduciary than an Investment Advisor.



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<sup>16</sup> ERISA § 404(a)(1)(A).

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## How should a fiduciary investment professional be selected ?

The decision to hire a financial investment professional is, itself, a fiduciary decision. Therefore, it is important that, like all fiduciary decisions, a carefully documented process be followed in order to ensure that one's fiduciary obligations are satisfied.<sup>17</sup> With regard to hiring any retirement plan service provider, this process should include interviewing multiple reputable candidates ideally in a "request for proposal" ("RFP") format. In addition to attempting to certify the qualifications and competence of any retirement plan service provider candidate during the RFP process, it also is important to attempt to detect and avoid any conflicts of interest. In the context of potential conflicts of interest, the appearance of impropriety can at times be almost as damning as an actual conflict of interest. This is due to the efforts that can become necessary in response to a need to explain and/or defend an apparent conflict of interest. Thus, it generally is recommended to avoid such situations in their entirety.

Regarding specific areas of inquiry when interviewing a prospective Investment Manager or reviewing the ongoing performance of an existing Investment Manager, the attached checklist at the end of this document sets forth multiple questions and concerns. Each of these issues should be vetted to the satisfaction of the Responsible Plan Fiduciary. With respect to reviewing the performance of an existing Investment Manager, these issues should be revisited on at least an annual basis.

## Impact of hiring a fiduciary Investment Manager

As suggested above, retaining an Investment Manager allows a Responsible Plan Fiduciary to broadly delegate his or her discretionary retirement plan investment decision making to a professional third party. From the perspective of insulating oneself from potential liability, this is an extremely desirable result and should be seriously considered. Notwithstanding, it is imperative that a Responsible Plan Fiduciary remember that, even after hiring an Investment Manager, he or she has not been absolved of all fiduciary obligation in association with investment-related decision making. In this regard, a Responsible Plan Fiduciary retains the duty to continually monitor the performance of the Investment Manager and, in the event that the Investment Manager is not performing adequately, replace them.<sup>18</sup> Again, the checklist at the end of this document is also intended to provide guidance on issues to consider when reviewing the performance of an Investment Manager.

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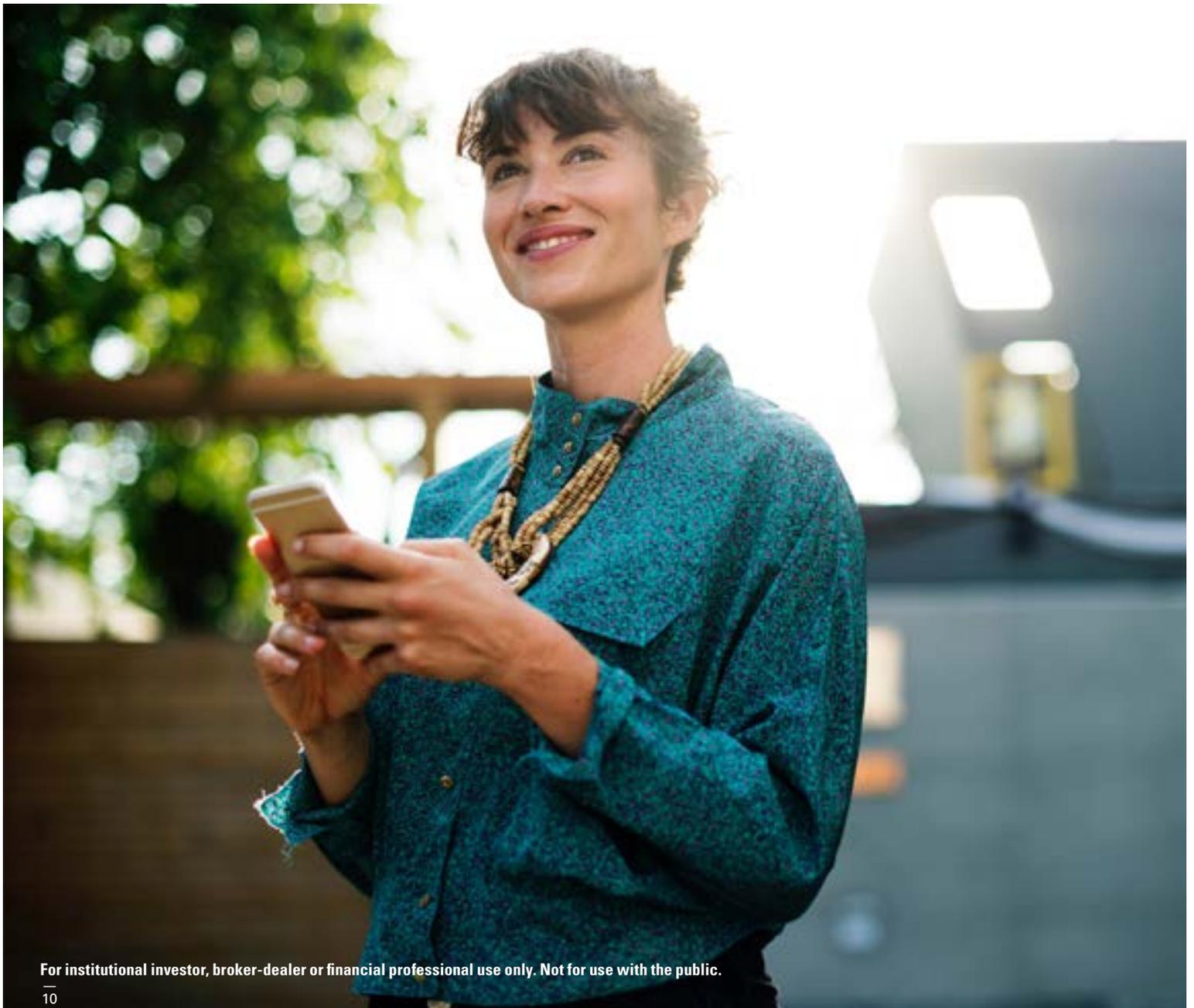
<sup>17</sup> *White v. Chevron*, Case No. 16-cv-0793-PJH (N.D. Cal. Aug. 29, 2016); quoting *Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983); *Tatum v. RJR Pension Inv. Comm.* 761 F.3d 346 (4th Cir. 2014) quoting *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 420 (4th Cir. 2007); see also *Pension Benefit Guar. Corp. ex rel. St. Vincent v. Morgan Stanley Inv. Mgmt.*, 712 F.3d 705, 716 (2nd Cir. 2013).

<sup>18</sup> See ERISA §§ 402(a)(2), (c)(3); 405(c).



# CONCLUSION

It is imperative that plan sponsors and Responsible Plan Fiduciaries understand their fiduciary exposure when establishing and maintaining an ERISA retirement plan. Based on the allegations made within most of the ERISA lawsuits filed in the last 10 years, it is easy to infer that the primary source of fiduciary exposure relates to plan investments. One way to avoid some of the fiduciary exposure associated with the investments of an ERISA plan is to hire an investment professional who is willing to serve in a fiduciary capacity. When insulation from potential ERISA fiduciary liability associated with retirement plan investments is the primary concern, the retention of an Investment Manager provides the greatest level of protection. However, it is of critical importance that the Responsible Plan Fiduciary charged with selecting the Investment Manager recognizes and honors the ongoing obligation to monitor the performance of such entity and, when necessary, to replace them.



# EXHIBIT A

The following checklist is intended to help a plan sponsor’s fiduciary decision makers with their duty to evaluate an Investment Manager in the context of interviewing and hiring or monitoring ongoing performance.

Investment Manager hiring/monitoring checklist		Yes	No
1	Is the entity providing Investment Management services a Registered Investment Advisor (“RIA”), bank or insurance company?		
2	Is the provision of Investment Management services the primary focus of the business offering such services?		
3	Does the Investment Manager take full responsibility for fund selection, fund mapping and “qualified default investment alternative” (“QDIA”) fund selection?		
4	Will the Investment Manager independently implement and effectuate the investment decisions that it makes as the recordkeeper on behalf of the plan sponsor?		
5	Does the Investment Manager periodically participate in retirement plan investment meetings held by the plan sponsor and provide thorough written documentation of its actions and the results of its investment decisions?		
6	Does the proposed or ongoing actions and services of the Investment Manager comport with the terms of the plan sponsor’s Investment Policy Statement?		
7	Does the entity providing Investment Management services maintain an ERISA fidelity bond and adequate errors and omissions insurance?		
8	Does the entity providing Investment Management services have any independent certifications attesting to the quality of the services it provides?		
9	Are there any recordkeepers or other retirement plan service providers that the Investment Manager will not work with?		
10	Are there any recordkeepers or other retirement plan service providers that the Investment Manager has a conflict of interest with?		
11	Have there been any recent changes to the control and/or executive leadership or otherwise significant personnel of the Investment Manager?		
12	Have there been any regulatory actions taken against the Investment Management firm?		

In the context of hiring or monitoring an Investment Manager, a Responsible Plan Fiduciary should be able to answer “yes” in relation to each of the questions 1–8 above. However, an answer of “yes” to questions 9–12 should inspire additional questions and further examination of the prospective or current Investment Manager. In the end, always be sure to consult with qualified retirement plan professionals if questions arise regarding your ERISA obligations or those of the service providers that work with your company’s retirement plan.

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### About Geoffrey M. Strunk

Geoffrey M. Strunk, Esquire, is the principal of the Law Offices of Geoffrey M. Strunk, LLC, a “boutique” ERISA law firm located in Glen Mills, Pennsylvania. Since 1998, Mr. Strunk has continuously maintained a private legal practice focused exclusively on the field of employee benefits. In that role, he routinely handles contested and procedural employee benefit matters, including the direct representation of plan administrators and fiduciaries before the IRS and the DOL. These responsibilities extend to the provision of compliance services involving government submissions and negotiations. In addition, he designs, drafts and consults on all forms of employee benefit pension plans with specialties in tax-qualified defined contribution plans and all forms of non-qualified plans.

Mr. Strunk also fulfills a compliance consulting role for certain recordkeepers and third-party retirement plan administration companies. In this context, he serves as a legal resource for marketing/sales staff and retirement plan administrators in order to help ensure the compliant design, maintenance and operation of their client’s retirement plans. Immediately prior to establishing his own law firm, Mr. Strunk served as Senior Vice President and General Counsel of ExpertPlan Consulting Services. In that role, his responsibilities included, among others, the management of the consulting services division within ExpertPlan, Inc., as well as the direct provision of consulting services to clients. Mr. Strunk received his Juris Doctor from Villanova University School of Law and his undergraduate degree from the Pennsylvania State University. He is licensed to practice law in the states of New Jersey and Pennsylvania.

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