CONFLICTS BRING LIABILITY TO RETIREMENT PLAN FIDUCIARIES: THE ETHICS OF SERVING TWO MASTERS

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Decisions and transactions in the investment world are often based on information from a trusted relationship. As a Fiduciary to an endowment, a foundation, or a qualified retirement plan, there is an extra level of due diligence that is required in order to assure that conflicts of interest do not surface after an arrangement is in place or a transaction has been completed. Conflicts of interest can make your organization or your retirement plan an attractive target for a plaintiff's attorney.

Recent history shows that these conflicts are not understood and/or not well researched up front leading to enterprise level risks that could have been avoided with a bit of work up front. This session will explore the issues and identify the paths to understand, and eliminate, these risks.

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INTRODUCTION

It has long been said, “A man cannot serve two masters.”

Despite such sage admonitions, this practice is not only common in the context of employee benefits; it is both expected and condoned. In the following paragraphs, we will discuss the spectrum of fiduciary duty and services offered by third party investment professionals. The level of expertise and services ranges greatly and can have a significant effect on the fiduciary liability retained by the hiring fiduciary. From non-fiduciary investment professionals, to those with conflicts or those that lack the requisite expertise to truly serve a qualified retirement plan prudently, it is the lack of factual understanding that creates peril for the Plan Sponsor and their fiduciary committee.

The goal in this article is to educate the reader on the practical aspects of how the financial advisor industry operates and expose the many pitfalls embedded in a preponderance of “fiduciary structures.” Ultimately, an educated fiduciary is far less likely to invite the class-action lawsuits that are permeating the retirement plan marketplace. In addition this article will explore the inverse relationship between the role assumed by an investment professional and the fiduciary responsibility retained by a plan sponsor or a fiduciary committee and explain how the scope of responsibilities change from one end of the investment professional spectrum to the other.

The article concludes with the following key attributes that should exist if one is to properly engage a third-party investment professional:

1) The third-party professional must possess the requisite expertise, skills and tools to provide the services needed by the plan,
2) The third-party investment professional must unequivocally and expressly recognize its status as a fiduciary, and
3) The third-party investment professional must possess absolutely no conflicts of interest, which might negatively affect the third-party investment professional’s judgment.

Given the duties and ethical obligations imposed upon legal counsel, understanding these realities is especially important when one is either representing an employee benefit plan directly or representing those who are responsible for, or providing services to, an employee benefit plan. After all, it is difficult for legal counsel, or anyone for that matter, to act in the best interests, or zealously advocate on behalf, of a client if one does not first identify exactly who the client is or completely understand the legal duties and obligations for which the client itself is, or may be, responsible.

These issues routinely arise in the context of all employee benefit plans, but are particularly common when dealing with pension or retirement plans that are subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). For this reason, the following discussion focuses predominantly on defined contribution retirement plans (e.g. 401(k) plans) that are governed by ERISA.

It is important to first appreciate that virtually all actions that might be taken with respect to a plan can be classified in one of two mutually exclusive categories:

SETTLOR VERSUS FIDUCIARY

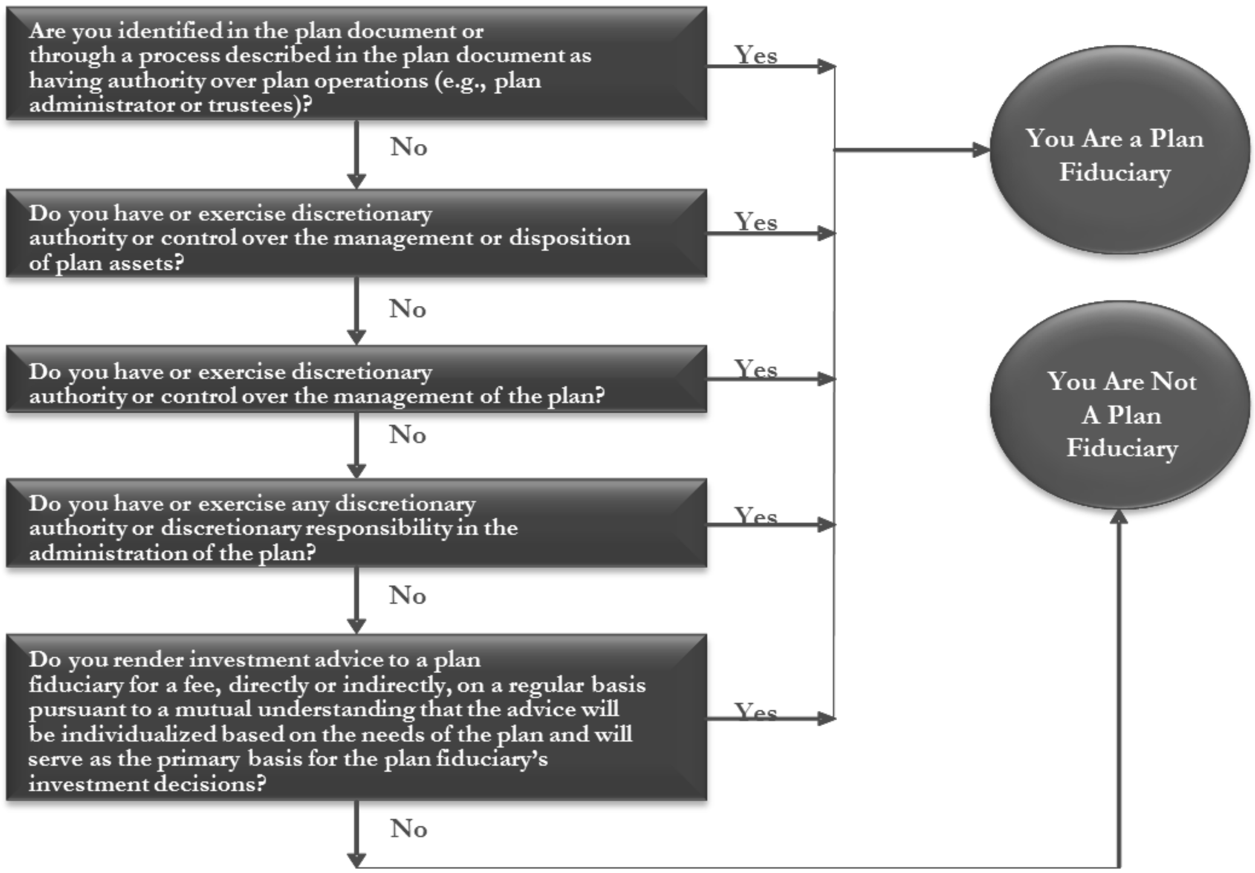
1) Actions that are "settlor" in nature and
2) Actions that are "fiduciary" in nature.

This distinction is important, as settlor actions create no duty to the plan or its participants, whereas fiduciary actions create some of the highest duties under the law. Although the nuances surrounding these distinctions are beyond the scope of this article a general "rule of thumb" exists: Since fiduciary status arises from one's actions or functions rather than by title, the definition of the term "fiduciary" in Section 3(21) of ERISA can serve as a guideline, if not a checklist, for legal counsel and others to determine which actions which are fiduciary in nature and which are not. In other words, a person is likely acting in a fiduciary capacity if his or her actions fall within one of the areas enumerated in Section 3(21) of ERISA and in a settlor capacity if they do not. Specifically, Section 3(21) of ERISA provides in relevant part as follows

"[A] Person is a fiduciary with respect to a plan to the extent [they]:

1) exercise any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,
2) render investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or
3) have any discretionary authority or discretionary responsibility in the administration of such plan."

The following flowchart helps to summarize when one's actions may be fiduciary in nature:



Named Fiduciaries

As a threshold matter, it is worth nothing that all plans that are subject to ERISA must have one or more parties specifically designated as the party that possesses the responsibilities reflected in Section 3(21) of ERISA and summarized in the flowchart above. The parties so designated are commonly referred to as "named fiduciaries." It is also worth noting that it is commonplace for 401(k) and other employee benefit plans to specifically designate the plan sponsor, or a committee comprised of executives or senior management who are employed by the plan sponsor, as the "named fiduciary" of the plan. So, it is commonly the plan sponsor or a committee of the plan sponsor who, by default, possesses the discretionary authority and control over all plan-related matters and, therefore, is acting as a fiduciary with respect to such matters—whether or not the plan sponsor or the committee is even aware of these obligations or duties. Ignorance of this reality can prove to be a trap for the unwary.

Functional Fiduciaries

Administrative Activities

Focusing first on those plan matters that involve management or administrative actions, it's worth noting that each requires some level of discretionary authority or control. To fully understand the importance of this, it is helpful to appreciate how most plans are designed and reemphasize that:

1) The design of a 401(k), or any benefit plan for that matter, is typically deemed to be a settlor act and not a fiduciary act.
2) ERISA specifically mandates that all employee benefit plans have one or more "named fiduciaries."
3) One's status as a "named fiduciary" does not subject the party so named to a higher standard of care than a party who is merely acting as a fiduciary by virtue of its functions, but instead reflects the party who, by default, possesses the discretionary authority or control with respect to one or more of the fiduciary actions described above in section 3(21) of ERISA.

Of course, many plan sponsors are corporations or other entities that cannot take action directly with respect to a plan without the involvement of people. For this reason, when the plan sponsor has designated itself as a plan's "named fiduciary," it is common for the plan sponsor to delegate all or part of its responsibilities to one or more employees or a committee that is comprised of employees (usually executives or senior management). Doing so does not, however, absolve the plan sponsor from all fiduciary responsibility, as all delegations of fiduciary responsibility require the delegating party (the "Delegating Fiduciary") to (i) exercise prudence in the selection of the party to whom the responsibility is being delegated (the "Delegated Fiduciary") and (ii) monitor the actions of the Delegated Fiduciary to ensure that it is fulfilling its obligations and responsibilities. For legal counsel, or anyone acting on behalf of an employee benefit plan, ignorance of these realities can prove to be a trap for the unwary.

One trap that plan fiduciaries can unwittingly fall into arises when they are unaware that ERISA requires all plan fiduciaries to act as prudent experts, not merely reasonable persons, when fulfilling or executing their fiduciary obligations. ERISA is also clear that if, or when, a fiduciary lacks the specific expertise, skills or tools necessary to act as a prudent expert with respect to a plan, an <u>affirmative obligation</u> exists to seek such expertise from a third-party who does. For this reason, among others, it is not uncommon for plan sponsors or fiduciary committees to engage a third party to act as the plan's trustee and/or custodian or to assist with the administration or record keeping duties associated with a the plan.

Unfortunately, many plan sponsors or fiduciary committees fail to recognize, or fully understand, the scope and magnitude of the services being provided by these third parties.

For instance, while it is relatively common practice for an institutional trustee to be engaged on behalf of a plan, many trustees act solely in a directed capacity. As a result, while trustees by default are deemed to be fiduciaries, to the extent that their actions are directed by the plan sponsor or a fiduciary committee, the breadth or scope of an institutional trustee's fiduciary responsibilities may be greatly limited and, in large part, functionally retained by the plan sponsor or the fiduciary committee.

In addition, it is common for agreements with third party administrators and record keepers to specifically state that they are merely serving in a ministerial role and taking directions on behalf of the plan sponsor or the fiduciary committee and that they do not actually possess any discretion or authority over the actions being taken, facilitated or implemented.

Whether the inclusion of such self-serving language in these third parties' form contracts is or will be respected is subject to a facts and circumstances analysis due to the functional nature of fiduciary status under ERISA. More importantly, such a determination is largely relevant only to the third-party service provider, because the plan sponsor or fiduciary committee will still virtually always retain at least some fiduciary responsibility in either event.

Remember, if the third party is deemed to be acting in a ministerial, non-fiduciary role, then, by default, it is the named fiduciary that possesses the requisite discretionary authority and control over the decision and is therefore ultimately responsible. In fact, even if the third party is deemed to have been acting in a fiduciary capacity, ERISA, and the case law surrounding it, make it clear that a delegation by a fiduciary to a third party does not fully relieve the delegating party of all obligations.

While a Delegating Fiduciary will not be the guarantor of the Delegated Fiduciary's actions, the Delegating Fiduciary will be shouldered with the burden of establishing that prudence was exercised in the selection of the Delegated Fiduciary and establish that ongoing monitoring of the Delegated Fiduciary occurred.

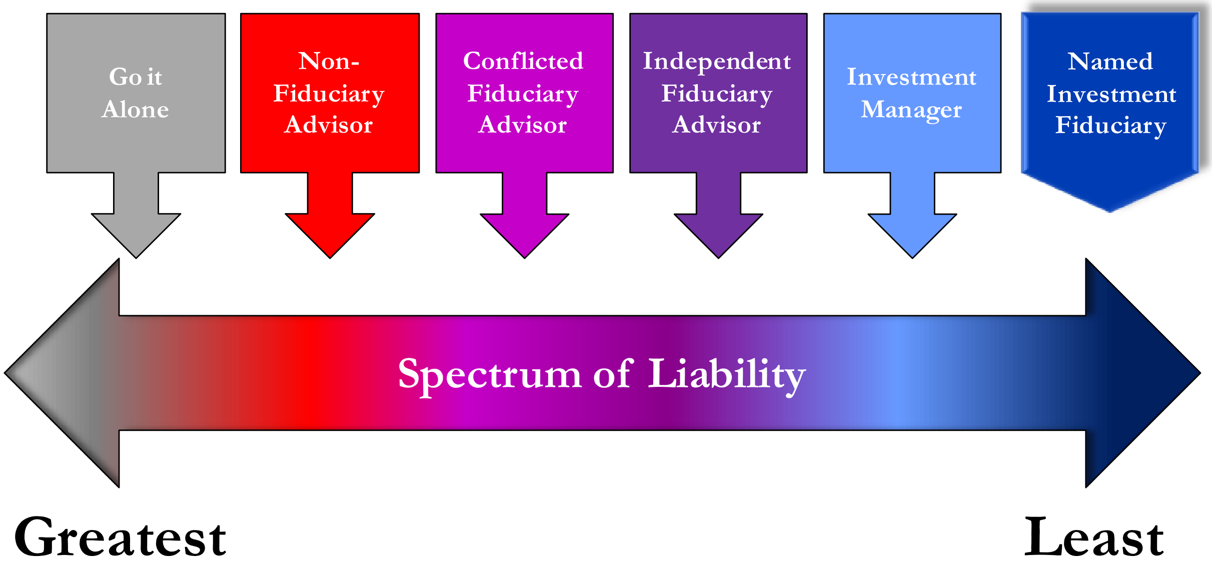
Investment Activities

The nuances described in the paragraphs above are even more relevant in the context of investment related fiduciary matters. This is due in large part to the unique skills, expertise and tools necessary to fulfill these duties.

For example, it is common for the Chief Financial Officer ("CFO") or other individuals with extensive financial education and background to serve as members of a fiduciary committee. While such individuals commonly possess the necessary skills to understand the charts and reports typically used to evaluate an investment's performance, such individuals may not possess:

1) The necessary expertise to identify the asset classes from which the various investments should be selected,
2) The necessary expertise to evaluate which investments within each asset class are best suited for the plan, or
3) The tools needed to synthesize the enormous amount of data that must be evaluated in order to assess performance over various time periods, not only on an absolute basis, but also relative to any applicable benchmark indices and peer groups.

Additionally, judgment and subjectivity is an essential part of investment management. Therefore, since ERISA mandates that a fiduciary seek assistance from a third-party whenever the fiduciary itself lacks the necessary skills, expertise or tools required to satisfy the relevant standard of care, many plan sponsors or fiduciary committees seek assistance from third-party investment professionals rather than simply "going it alone."



When it comes to selecting a third-party investment professional, it is incumbent upon the plan sponsor or fiduciary committee to fully understand the following:

1) The scope of the investment-related responsibilities that the investment professional is willing to assume.
2) Whether the investment professional possess the skills, expertise and tools necessary to fulfill its investment related responsibilities.
3) The relationships and affiliations that the investment professional has with respect to various third parties that may also be direct or indirect providers to the plan.

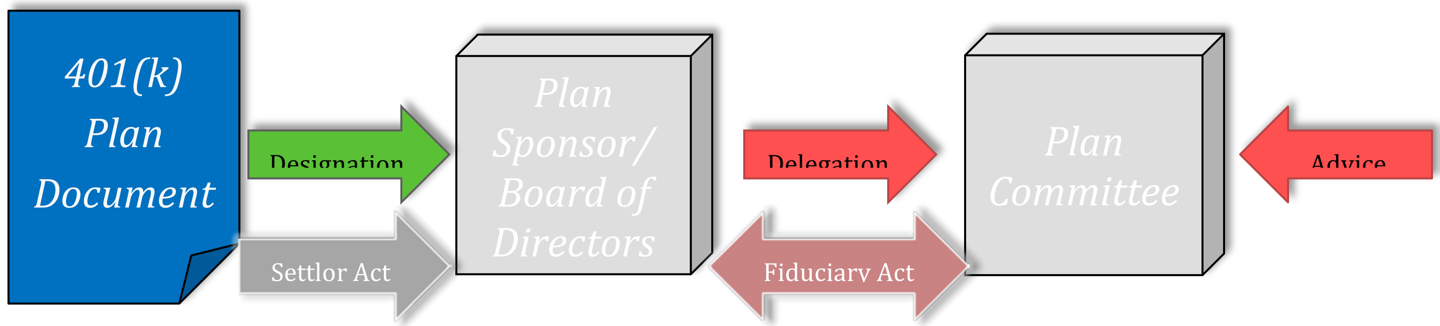
Unlike the other ways in which fiduciary status arises, if the investment professional lacks specific discretionary control or authority over plan investment-related matters, then he or she will only be a fiduciary to the extent the services being provided constitute the provision of "investment advice for a fee." This can have significant effect on the liability created for the plan sponsor and other plan fiduciaries. For example, in the recent case of *Tiblier v. Dlabal (No. 13-50344, February 28, 2014) the* 5th Circuit Court of Appeals held that a registered investment adviser representative was not liable for an ill-advised investment that was recommended to, and ultimately made by an ERISA plan, because the representative was paid by a third party and did not receive a fee from the plan. In other words, although the representative provided investment advice, it was not deemed to be for a "fee." As a result, the court concluded that the representative was not a fiduciary to the plan and therefore could not breach a fiduciary duty that he did not have.

On its face, it would appear simple to identify if or when a third-party is providing investment advice for a fee; however, like many aspects of ERISA, things are not always as they seem.

Once again, the devil is in the details. Ironically, responsibility for the confusion surrounding this determination lies in large part with the Department of Labor (the "DOL") itself. This is because the DOL issued regulations interpreting what constitutes the "provision of investment advice for a fee" shortly after ERISA was passed, which ironically also predated the very existence of 401(k) plans by a number of years. Specifically, in 1975, the DOL created a five-part regulatory test, which requires that each part be satisfied in order for an individual or group to be characterized as a fiduciary by virtue of the provision of investment advice for a fee. In other words, failure of any one of the five parts is enough to avoid characterization of an investment professional as a fiduciary. Under the regulation, before a person can be held to ERISA's fiduciary standards with respect to their advice, they must: (1) make recommendations on investing in, purchasing or selling securities or other property, or give advice as to their value (2) on a regular basis (3) pursuant to a mutual understanding that the advice (4) will serve as a primary basis for investment decisions, and (5) will be individualized to the particular needs of the plan.

An investment adviser is not treated as a fiduciary unless each of the five elements of this test is satisfied for each instance of advice.

The following discussion explores the inverse relationship between the role assumed by an investment professional and the fiduciary responsibility retained by a plan sponsor or a fiduciary committee and explains how the scope of responsibilities change from one end of the investment professional spectrum to the other.



Intentionally failing one or more of the criteria reflected in the five-part test above is quite easy. In fact, the simple inclusion of a self-serving statement by an investment professional in its agreement with a plan which states that the investment professional is not a fiduciary expressly and specifically demonstrates a lack of mutual consent among the parties that the investment professional is serving in a fiduciary capacity and therefore violates the third criteria in the five-part test above. This alone is arguably enough to cause the investment professional's advice to be classified as non-fiduciary in nature.

Historically, the inclusion of such language within the form agreements used by third-party investment professionals is common. Unfortunately, many plan sponsors and fiduciary committees are unaware of this practice, and, as a result, both unwittingly rely on the recommendations provided by such non-fiduciary advisers and mistakenly believe that these advisors are fiduciaries who are acting in the best interests of the plans participants.

Of course, this is not to say that all recommendations provided by non-fiduciary adviser are bad or solely self-serving, but, given that they have no fiduciary duty to the plan and its participants, the plan sponsor or fiduciary committee that has engaged them, should consider to whom exactly these non-fiduciary advisers do owe a duty. More importantly, plan sponsors and fiduciary committees that engage non-fiduciary advisers to provide investment recommendations should consider how they can ever justify the hiring of a party that owes the plan and them no fiduciary duty should a problem ever arise.

Based on the discussion above, at least from the perspective of a plan sponsor or fiduciary committee, it would appear that engaging a third-party investment professional that serves as a non-fiduciary advisor may not be much better than the plan sponsor or the fiduciary committee "going it alone."

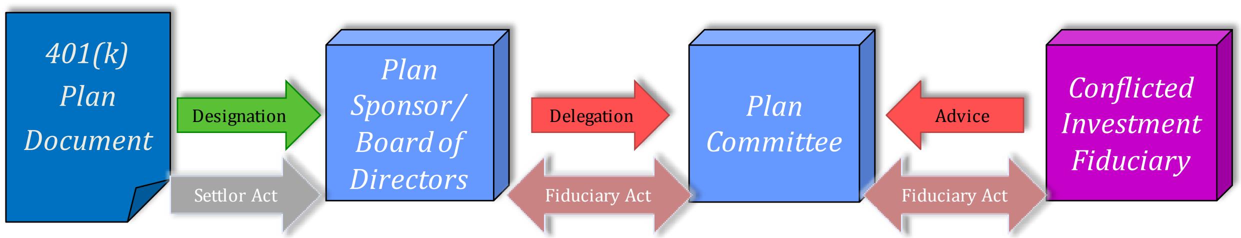
Ironically, the mere engagement of a non-fiduciary adviser could arguably be used as evidence to reflect that a plan sponsor or fiduciary committee lacks the requisite skills necessary to make investment-related decisions and satisfy the prudent expert standard imposed under ERISA (otherwise there would have been no need to engage the third-party in the first place). The plan sponsor or fiduciary committee has arguably breached their duty by engaging a third-party that owes no fiduciary duty to the plan and its participants.

In short, it is rational to conclude that when an investment professional is unable or unwilling to expressly recognize their status as a fiduciary to a plan and its participants, the party responsible for engaging the investment professional (typically, the plan sponsor or a fiduciary committee) would be wise to seek guidance and advice somewhere else.

Sadly, the analysis does not end here, as additional subtleties and nuances must be considered at an even more granular level to ensure that the interests of the plan and the third party investment professional are truly aligned.

Given that the same legal standards are imposed upon all fiduciaries, it would be rational to conclude that all third party investment professionals that agreed to act in a fiduciary capacity are functionally the same. This assumption, however, is far from correct.

THE CONFLICTED INVESTMENT FIDUCIARY



As previously noted, fiduciary status with respect to plan-related investment matters can arise functionally in one of two manners: (1) when someone exercises discretionary control or authority over plan assets, including the investment of plan assets, or (2) when someone provides investment advice for a fee.

When a third-party investment professional lacks the actual discretionary control or authority to make investment decisions, but instead provides investment advice to the party or parties who possess such discretionary control or authority, it is possible that the investment professional can satisfy its own fiduciary obligations by providing advice that, under the right circumstances, is prudent, while potentially creating liability for the party or parties that it is advising.

For example, a third party investment professional could in fact function as a fiduciary, but possess conflicts of interest that not only cloud the judgment of the third party investment professional, but render the recommended investment completely impermissible, due to the prohibited transaction rules imposed under ERISA. These include:

1) An affiliation with a broker-dealer,
2) The offering of one or more investment products that are managed by the third-party investment professional itself or one of its affiliates, or
3) The receipt of compensation, directly or indirectly, which arises from the investment recommendations

This is not to say that when such a conflict exists that all investment recommendations are *per se* imprudent. However, the purpose of engaging a third party investment professional is typically to assist the plan sponsor or a fiduciary committee with matters with respect to which they have implicitly, if not expressly, recognized that they are deficient (i.e., they have determined that they lack the requisite investment related skills, expertise or tools). So shifting the obligation from the third party investment professional back to the plan sponsor or the fiduciary committee to evaluate whether that recommendation is truly in the best interests of the participants would be both inequitable and problematic to say the least.

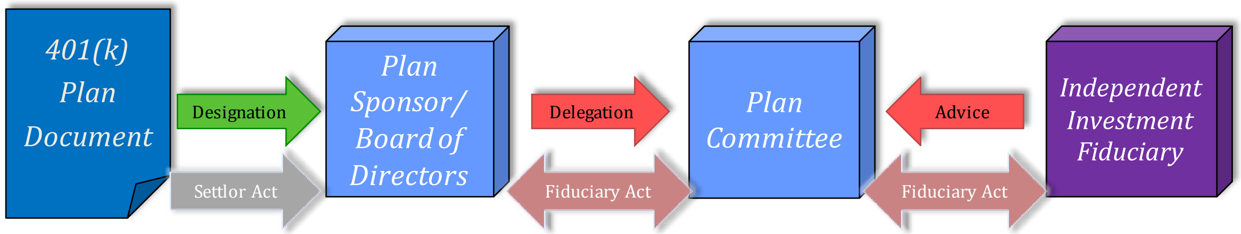
In fact, due to ERISA's strict limitations regarding what are characterized as "prohibited transactions," if a "party in interest", which includes a fiduciary and its affiliates, enters into a transaction with a plan, regardless of how beneficial the transaction is for the plan, the transaction is expressly prohibited and impermissible unless an exemption applies. The most notable exemption that exists in this setting permits such a transaction, but **only if an independent third-party fiduciary approves the transaction**.

Amazingly, the independent third-party fiduciary that commonly approves such related party transactions is actually the plan sponsor or the fiduciary committee. In other words, to the extent a conflicted fiduciary adviser has been engaged, it is not unusual for the conflicted fiduciary adviser to need the plan sponsor or the fiduciary committee more than the plan sponsor or the fiduciary committee might actually need the conflicted investment advisor.

Much like the situation with a non-fiduciary investment professional, if a plan sponsor or fiduciary committee engages a conflicted investment fiduciary, it does so at its own peril, since it may find itself responsible for approving conflicted advice. For this reason, at a minimum, the plan sponsor, the fiduciary committee and legal counsel should request and review, in great detail, the investment professional's Form ADV, which can be found by searching on the Securities Exchange Commission's ("SEC's") website. While review of an investment professional's Form ADV may not uncover all existing conflicts of interest, it will routinely reflect many.

One specific tactic that can be utilized to obtain information on conflicts of interest is to go directly to Part II of an investment professional's Form ADV and search for the word "conflict." This simple exercise will often identify conflict issues immediately and yield ample information for clarifying questions.

THE INDEPENDENT INVESTMENT FIDUCIARY



Additional due diligence is still required, even when the plan sponsor or a fiduciary committee has concluded that the third-party investment professional that has been engaged is free of conflicts of interest. After all, ERISA and the courts are clear that a "big heart and an empty head" will not serve as a valid defense or justification for failing to satisfy the prudent expert standard imposed under the law. Therefore, once a third-party investment professional is identified as an un-conflicted fiduciary, it is still necessary to determine whether or not the un-conflicted fiduciary possesses the skills, expertise and tools to provide the investment advice necessary to make expert decisions on investment-related matters.

Ironically, this means that the very party that has recognized a deficiency in its own investment related abilities - namely, the plan sponsor or the fiduciary committee - is tasked with evaluating the skills, expertise and tools possessed by the independent investment fiduciary. Worse still, the engagement of a third-party investment professional is implicitly, if not expressly, evidence that the plan sponsor or the fiduciary committee is deficient to some degree with respect to investment-related matters. To the extent the plan sponsor or fiduciary committee retains discretionary control and authority over the ultimate investment decisions, it will be retain responsibility for the decisions that it makes, no matter how good or bad the recommendation received by the independent investment fiduciary is. This too, underscores another inequitable result that exists under the law, at least in the context of defined contribution plans.

For example, focusing solely on investment decisions themselves, a third-party investment professional (regardless of their status as a fiduciary and the presence or absence of conflicts of interest) basically only does two things:

1) The third-party investment professional recommends the addition of an investment to a plan or
2) The third-party investment professional recommends the removal of an investment to a plan.[2]

[2] For purposes of this article, retention of an investment has not been separately addressed, but instead treated as an ongoing decision to purchase an investment. Additionally, it is common for investment policy statements to be drafted in a manner that contemplates retention, as a default, when removal is not warranted or recommended. Similarly, since replacement of an investment is functionally the

Interestingly enough, the plan sponsor or fiduciary committee really only has two responses to any of the investment recommendations made by a third-party investment professional – namely to:

1) Follow the recommendation of the third-party investment professional, or
2) Not follow the recommendation of the third-party investment professional.

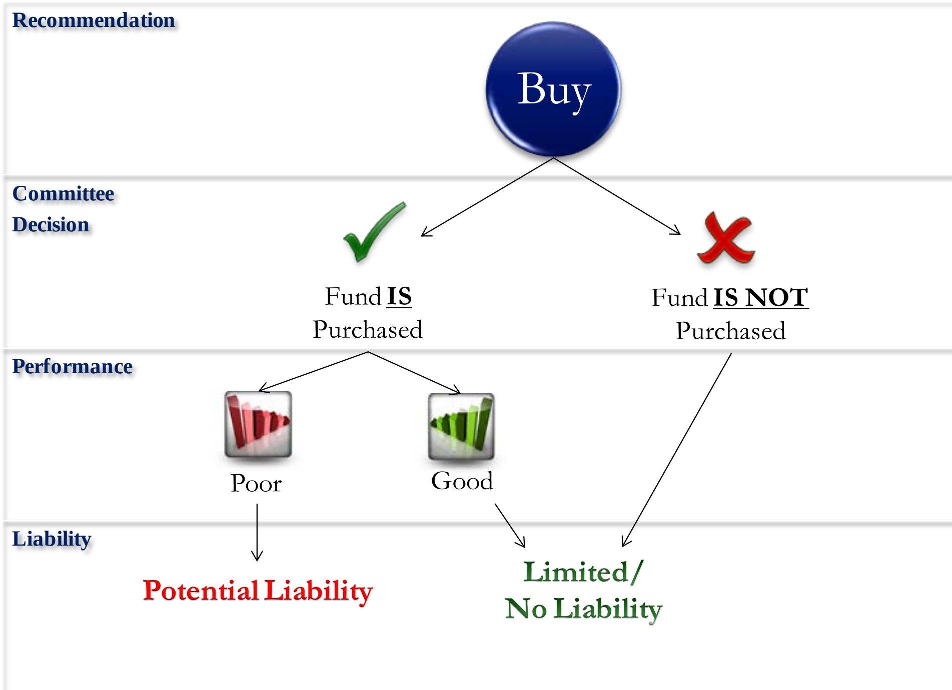
Clearly, if the plan sponsor or fiduciary committee follows the recommendation of the third-party investment professional and adds a particular investment to the plan, if the investment does well, the likelihood of litigation is limited. Ironically, even if the investment does poorly, provided that the necessary due diligence regarding investment has been done, the plan sponsor or fiduciary committee still has fairly limited liability in regards to this decision, as it is been recommended by the third-party investment professional that was engaged for the very purpose of making such recommendations. Of course, the reasonableness of such a decision pivots upon the skills, expertise and tools of the third-party investment professional, as well as the presence or absence of any conflicts of interest, and the professional's status as a fiduciary.

In contrast, if the plan sponsor or fiduciary committee elects not to follow the recommendation of the third-party investment professional and does not add the investment to the plan,[3] there is no obligation on the part of the plan sponsor or fiduciary committee to add a particular fund to the plan in the first place. So, in this instance, the likelihood of liability is limited.

The following flowchart reflects these realities:

removal of an investment coupled with a recommendation that a new investment be purchased or added to a plan's investment line-up, this concept has also not been separately addressed.

[3] Additionally, it is possible that a recommendation to add an investment, which is ultimately not followed, might not even be recorded in meeting minutes or otherwise be documented. As a result, as a practical matter, it may be difficult for anyone other than the investment professional and the fiduciaries responsible for investment decisions to ever even learn that the recommendation was not followed.



This brings us to the recommendation by third-party investment professional to remove an investment from the plan. Much like the prior discussion, the plan sponsor or fiduciary committee has two choices:

1) Follow the recommendation of the third-party investment professional, or
2) Not follow the recommendation of the third-party investment professional.[4]

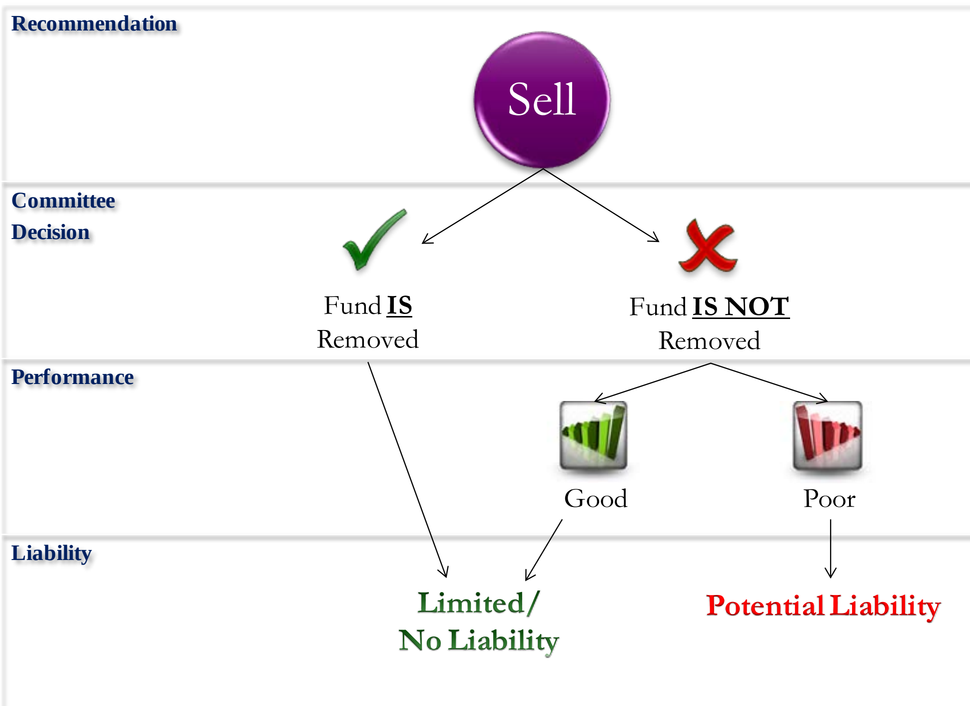
If the plan sponsor or the fiduciary committee follows the recommendation of the third-party investment professional and removes the investment there is limited risk or exposure to the plan sponsor or the fiduciary committee, given that they have followed the advice of the party that was engaged for its expertise in investment related matters. Once again, this assumes that the third-party investment professional acts as a fiduciary, possesses the necessary skills, expertise and tools to satisfy the prudent experts standard of care mandated under ERISA, and does not possess any conflicts of interest that may jeopardize the objectivity of their recommendation.

Alternatively, if the plan sponsor or fiduciary committee chooses not to follow the third-party investment professionals recommendation only two outcomes exist. Specifically, either the investment's performance will improve, or the investments performance will continue to degrade, as predicted or suggested by the third-party investment

[4] For purposes of this article, retention of an investment has been considered equivalent to an ongoing decision to acquire an investment or the inverse of a decision to remove an investment. For this reason, recommendations to retain an investment have not been separately addressed. Nonetheless, the implications for fiduciaries who elect to not follow the advice of an investment professional are generally the same.

professional. If the investment's performance improves, contrary to the expectation of the third-party investment professional, the plan sponsor or fiduciary committee will have limited exposure to liability. However, if the investment performance continues to degrade or underperform as predicted by the third-party investment professional, the plan sponsor or fiduciary committee may face significant liability for their decision as it was contrary to the recommendation of the very party that they've identified as having greater expertise in such matters.

Like the previous flowchart, the following reflects the realities surrounding recommendations to remove an investment:

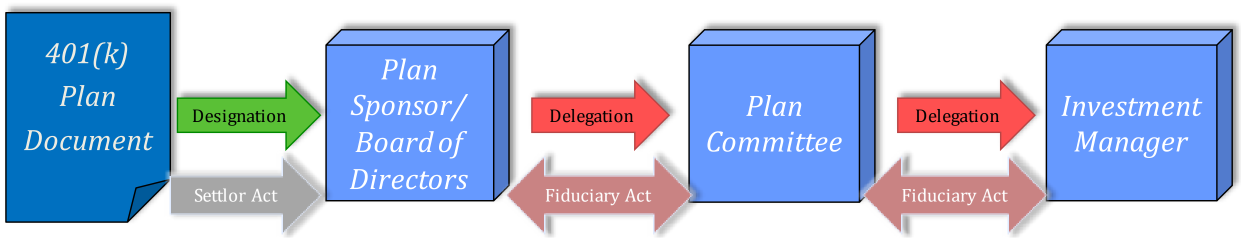


In short, when analyzing the recommendations that might be made by an investment professional and the alternatives that are available to a plan sponsor or fiduciary committee, if the plan sponsor or fiduciary committee wish to minimize, or at least mitigate, their liability and exposure to claims for breach of fiduciary duty, provided that the investment professional is serving as an un-conflicted fiduciary and possesses the necessary investment skills, expertise and tools, their only rational decision is for them to follow the advice of the independent investment professional that they have engaged.

Of course, if the plan sponsor or fiduciary committee exercised the necessary due diligence when the third-party investment professional was first engaged, and, if they continue to monitor the third-party investment professional's structure and relationship with other parties, as required by ERISA, concerns regarding the investment professional's capability, fiduciary status and conflicts of interest should not exist.

In other words, if the plan sponsor or fiduciary committee does its job correctly up front, their only rational course of action is to follow all of the recommendations of the investment advisor. Ironically, this functionally reduces the plan sponsor or investment committee to a bunch of "yes men" who, in essence, do little more than "rubberstamp" the recommendations of the investment professional. Unfortunately, to the extent a plan sponsor or a fiduciary committee retains the ultimate discretion over the investment decisions, they may still be liable for a claim for breach of fiduciary duty if it should ever occur that the investment professional's recommendation was imprudent, In other words, even when a plan sponsor or a fiduciary committee takes all of the necessary steps to ensure that the best decisions are made, if they retain ultimate discretion over the investment decisions, they may also retain potential liability for the decision, despite the reasonableness of their reliance on the recommendation of the investment professional.

THE INVESTMENT MANAGER



One way to mitigate this exposure is to go beyond the engagement of an investment professional to provide advice and instead completely transfer the discretionary function for investment matters from the plan sponsor or the fiduciary committee to the investment professional, as contemplated in the definition of the term "investment manager," which is defined in Section 3(38) of ERISA. It is noteworthy, that a delegation of authority to an investment manager does not completely absolve the Delegating Fiduciary (typically, the plan sponsor or a fiduciary committee) of all responsibility. While the Delegating Fiduciary is not the guarantor of the investment manager's actions, the Delegating Fiduciary will retain some residual fiduciary duty. Specifically, the Delegating Fiduciary will retain a duty of prudence in the selection of the investment manager and a duty to monitor the actions of the investment manager.

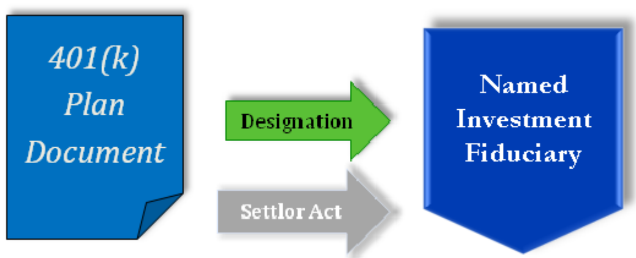
The most notable shortcoming or flaw is best understood by first revisiting the fiduciary structure that is typically used by defined contribution plans across the country. As previously discussed, many plan sponsors, when drafting the governing plan documents, elect to designate themselves as the "named fiduciary." However, given that most plan sponsors are corporations or some other form of business entity; they are unable to act independently without the involvement of people. For this reason, the DOL has routinely taken the position that when a company designates itself as the named fiduciary in a plan document, its Board of Directors is indirectly implicated and, by default, is also a fiduciary. Given the vast responsibilities of the typical Board of

Directors, it is not uncommon for the plan related responsibilities to be delegated to a fiduciary committee.

In an effort to avoid implicating the plan sponsor's Board of Directors, a fiduciary committee may be designated directly in the plan document rather than indirectly through a delegation by the plan sponsor or its Board of Directors; however, it is also common for a plan sponsor to indemnify the members of a fiduciary committee for any breaches that might occur, which, in large part, undermines any effort to remove the plan sponsor from the liability chain. Regardless of how a fiduciary committee obtains responsibility over investment matters, as has already been discussed, plan sponsors and fiduciary committees commonly lack the requisite investment skills, expertise or tools to prudently make informed investment decisions by themselves. To the extent they recognize this and ultimately delegate the responsibility for such matters to an investment manager, the very party that could have simply designated the investment manager directly the plan document, an act which would have arguably been a non-fiduciary settlor act, has instead chosen to create a series of unnecessary links in a liability chain - each of which ultimately leads back to the plan sponsor and oftentimes its Board of Directors.

In summary, while the typical approach may transfer discretionary investment authority to an investment manager, the obligation to exercise prudence in each link of the delegation chain and a duty for each party to monitor the group to whom it has delegated its responsibility still remains.

Designation Of An Independent Named Fiduciary



In the end, the party that is making the actual investment decisions, the investment manager, could have been designated directly in the plan document. Again, by **designating** the investment professional directly the plan sponsor would have arguably been acting in a settlor capacity and thus not acting as a fiduciary, which would have avoided implicating the plan sponsor, its Board of Directors, the fiduciary committee, and the executives and senior management that commonly comprise the fiduciary committee, and instead simply designated the very party that is best situated to make these decisions and on whom all of the other parties would be relying anyway. This is the structure that most fiduciary committee's think they have created when they engage and delegate investment authority to the third party investment professionals mentioned above.

While errors or failures may still occur, under this structure, the burden should not be shouldered by the plan sponsor, but rather by the third-party that has been designated as the named fiduciary. Furthermore, since, under this approach, the status of the named fiduciary for investment purposes is clearly and expressly reflected in the governing plan documents, any dispute regarding the responsibility and liability of anyone else regarding such matters should arguably constitute a question of law, as opposed to a question of fact. As a result, if named as a party to any litigation concerning breaches of investment related fiduciary duties; the plan sponsor may be able to avoid much of the pain associated with the litigation and instead resolve any disputes regarding its involvement through either a motion to dismiss or a motion for summary judgment.

Finally, even if the act of designating a third-party investment professional as the named fiduciary were ultimately found to itself be a fiduciary act (as opposed to a non-fiduciary settlor act), provided that the third-party investment professional meets the requirements reflected in section 3(38) of ERISA, the party that would ultimately be deemed to have delegated investment authority will merely need to demonstrate that it exercised the necessary prudence in the selection of the third-party investment professional and that the requisite monitoring of their actions occurred. Establishing prudence in the selection of the investment professional should not be difficult, as it should involve the same process and analysis that would be used when any investment professional is retained.

As for any residual duty to monitor that might then exist, in large part this obligation could be satisfied by mandating that the investment professional maintain records, meeting minutes and other documentation associated with the actions that it takes with respect to the plan and further mandating that such documentation be provided to the party responsible for the plan's administrative matters. Furthermore, since investment-related matters can rarely be addressed in a vacuum, but instead require the involvement of the party or parties who are responsible for the administrative and management functions of the plan (e.g. participant communications, decisions regarding the allocation of plan expenses, etc.) it would appear likely that the any duty to monitor the investment professional serving in this role would be satisfied.

CONCLUSION

Whenever a third-party investment professional is going to be engaged, it is imperative that the parties responsible for the engagement ensure that the third-party investment professional:

1) Possess the requisite investment skills, expertise and tools to provide the services needed by the plan,
2) Unequivocally and expressly recognize its status as a fiduciary, and
3) Possess absolutely no conflicts of interest which might otherwise negatively affect the third- party investment professional’s judgment.