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Options for Investment Help

Two main ways to get fiduciary advice
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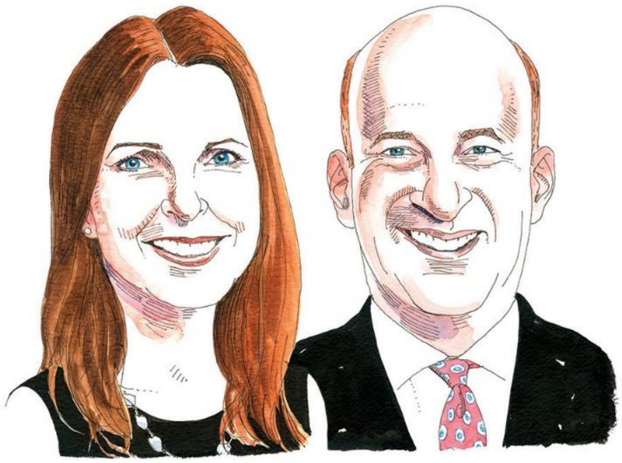

Art by Joe Ciardiello

Even if retirement plan participants decide how to allocate their accounts from among their plan's investment options, selecting those options is a fiduciary responsibility.

When selecting and monitoring investment options, a plan's committee members are held to a special fiduciary standard often referred to as the prudent man rule. This means committee members must act with the care and skill that a prudent person would if acting in a similar capacity and being familiar with such matters.

But most committee members are not investment experts and don't know what type of prudent process to follow. So what should they do? Hire a discretionary investment manager—what we refer to here as a 3(38) investment manager—to select the investments. Alternatively, they can hire a nondiscretionary investment adviser—referred to here as a 3(21) investment adviser—to provide advice.

How the Two Types Differ

For committees deciding between the two types of advisers, 3(38) investment managers are fiduciaries that take on responsibility for selecting the plan's investment options. While the committee doesn't choose the plan's investment lineup, it retains the obligation to prudently select and monitor the investment manager. Typically, the investment manager selects the plan's investment options, including the qualified default investment alternative (QDIA), monitors investment performance and makes changes as he deems necessary. He reports back to the committee periodically so it can monitor his performance.

A 3(21) investment adviser is also a fiduciary, but, instead of selecting investment options, he provides the committee with investment advice and recommendations. In addition, he assists with monitoring performance and recommends when to remove or replace an investment option. While the adviser is a fiduciary with respect to providing such investment advice, the committee retains fiduciary responsibility for the ultimate investment-option decisions and uses the 3(21)'s assistance to engage in a prudent process and to make prudent investment decisions.

Which Type Will Be a Better Fit?

The right answer is the one that works best for a particular committee and its plan(s). Here are a few factors to consider:

• By hiring a 3(38) investment manager and delegating responsibilities, the committee potentially reduces plan liabilities, while lessening its engagement and giving up control.

• Even though responsibility for selecting some or all of the investment options may be delegated to the 3(38) investment manager, the committee still has fiduciary responsibility to monitor the manager. This requires that the committee understands the investment manager's methodologies and monitors his performance on an ongoing basis.

• Because of the liabilities associated with taking on investment responsibility, investment managers generally charge more than do investment advisers. However, by taking advantage of the 3(38)'s greater "buying power," a committee could potentially offer participants investment options with significantly lower fees. This may mean the funds offered to plan participants will no longer be brand name funds but more generic, "white labeled" funds. The committee must consider how any additional cost correlates with any risk reduction.

• With a 3(21) investment adviser, the committee members may remain more interested and involved as they work with the adviser to better understand the plan's options, make decisions and get much needed investment help and guidance.

• The committee must still "ask the right questions" of its 3(21) adviser and not follow his advice blindly. The committee is ultimately responsible for the investment decisions.

Generally, 3(21) investment advice services are more suitable when the committee wants to reduce liability but still participate meaningfully in investment decisions; 3(38) investment manager services are generally more suitable when the committee does not wish involvement. The type of plan may be a relevant factor, as well. Often, we see committees hire a 3(38) to manage the investments held by a defined benefit (DB) plan, while using a 3(21) adviser to help select and monitor the investment options for a 401(k) or other defined contribution (DC) plan. However, 3(38) investment managers have been shifting focus toward finding solutions for DC plans, and this will likely continue.

Our next column will discuss monitoring an investment manager or adviser.

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