

Fiduciary Focus: Non-Fiduciary Investment Consultants (Part 2)

W. Scott Simon | 06-01-06

My article last month focused on a [broker-dealer investment consultant](#) to a 401(k) plan. In the consultant-drafted contract governing the plan fiduciaries and consultant, I detailed how that contract named the consultant as an ERISA section 3(21) fiduciary but then excised all language from the contract that would actually make the consultant responsible (and, therefore, liable) for any duties required of an ERISA section 3(21) fiduciary.

I also pointed out that ERISA-defined "investment advice" pertains only to investments and not managers--which is precisely why the language in the consultant-drafted contract (1) mentions only managers and not investments and (2) places the entire onus on the plan fiduciaries (not the investment consultants) for selecting and monitoring plan managers, not plan investments.

In addition, I noted that fiduciaries of 401(k) plans can derive real value in having an ERISA section 3(38) fiduciary, less value in having an ERISA section 3(21) fiduciary that actually assumes the duties of such a fiduciary, and no value (indeed, great harm) in having a "phantom" 3(21) fiduciary that supplies plan fiduciaries with deceptive contracts that are legally toothless against the consultant.

A number of you e-mailed me in response to the article and posed a very simple question: *Don't actions determine who a fiduciary is rather than what a contract says?* The follow-up example you provided was something like: In cases where a consultant picks (or even merely recommends) and monitors specific investment options for a 401(k) plan wouldn't the consultant's actions be enough to assign it fiduciary responsibility regardless of what its contract says since ERISA considers anybody that has influence over plan fiduciaries to have discretionary authority?

While the general question is perceptive, the example posed doesn't comport with the terms of the contract I described in the article. In that contract (representative of many others, sad to say), the consultant has no responsibility at all to pick (or even merely recommend) and monitor specific investment options. That responsibility remains solely on the shoulders of the plan fiduciaries. All the consultant had to do under the contract was pick managers for (and remove them from) its recommended list. The consultant had no duty whatsoever to say whether or not a particular manager (or managers) was "prudent" under an ERISA or SEC standard (or, my gosh, even "suitable" under the broker-dealer standard) for the particular plan in question.

I will run the risk of repeating myself since it's vitally important to understand precisely how those that supply such contracts to plan fiduciaries can get away with so much. As I put it in my article: "It's no accident under the terms of this contract that the investment consultant promises to provide due diligence and monitoring services only as to *Managers, not investments* offered in the 401(k) plan (and only for the purpose of determining whether the Managers should stay on the Recommended List, not whether the Managers are prudent (or even suitable) for the Client)." In this case (as well as many others), the consultant does not provide specific investment advice to the plan; the advice is simply generic.

The investment consultants employed at large broker-dealers are particularly notorious for supplying plan fiduciaries with contracts that eviscerate any real fiduciary responsibility under ERISA section 3(21), like the contract I examined in last month's article. This has to do with the simple fact that brokerage firms just don't want to be fiduciaries. They have assured that outcome via the government through such things as the SEC's adoption of the "Merrill Lynch rule" and via the private contracts they sign with their registered representatives where the only fiduciary duties in sight are those owed to the brokerage firms themselves (while clients are owed duties based on a mere "suitability" standard).

The problem with this situation is that ERISA section 3(21) requires that only a "plan

fiduciary" (defined as a (a) bank or savings and loan association, (b) insurance company or (c) registered investment adviser) can invest and manage ERISA assets. Not to worry: Broker-dealers can get their hands on such assets since every one of them is dually registered as a registered investment adviser. Broker-dealer investment consultants can corral those ERISA assets by supplying plan fiduciaries with contracts that gut--as explained in last month's article--any real fiduciary responsibility (and corresponding liability) the consultants would otherwise have under ERISA section 3 (21). (The mind that thought up this racket could surely solve Social Security's mess--and maybe even Medicare's.) Hey, I told you that brokerage firms just don't want to be fiduciaries.

Now let's get back to the general question posed: Don't actions determine who a fiduciary is rather than what a contract says? Well, yes and no. One way to determine whether an investment consultant to the fiduciaries of, for example, a 401(k) plan is a "real" fiduciary (as opposed to a phantom fiduciary supplying a deceptive contract that is legally toothless against the consultant) is to examine the contract between the fiduciaries and consultant.

If the contract spells out carefully and clearly that the consultant assumes responsibility as a real ERISA section 3(21) fiduciary, then it's easier for plan fiduciaries to mitigate their liability (by ensuring that the consultant at least shares in that liability) in situations where they are sued by plan participants.

If, on the other hand, the contract is supplied by a phantom ERISA section 3(21) fiduciary that pretends to be a fiduciary with real responsibilities, then it's tougher for plan fiduciaries when sued by plan participants under the terms of such contracts. In those situations, the contract works against the plan fiduciaries because it shows that the phantom consultant has no responsibilities--and, therefore, no liability. At that point, the "facts and circumstances" of the case become much more important. And therein often lies the problem of determining "functional" fiduciary status.

"Discretionary authority is discretionary authority," "discretionary control is discretionary control," and "rendering investment advice is rendering investment advice" when it's spelled out carefully and clearly in a contract. What constitutes "influence" or a "recommendation," however, is wide open to interpretation. In the absence of a clear contract, proving functional fiduciary status can be a big problem for plan fiduciaries looking for their investment consultants to stand beside them in participant lawsuits.

Suppose that an investment consultant shows a list of managers to its client, the fiduciaries of a 401(k) plan. The consultant gives them information on each manager and may even guide them towards specific ones "implying" (wink, wink) that they're good. Yet under the contract in question, it's still up to the plan fiduciaries to approve each manager. In that kind of situation, it's at least arguable whether the consultant has any real fiduciary responsibility (and, therefore, liability). If the consultant gets off the (legal) hook, then the plan fiduciaries stand alone in facing the plan participants' lawsuit. If it starts to look like the consultant will have to stand by the fiduciaries, then the consultant can always point to its trusty toothless contract that absolves it of any real fiduciary responsibility and get off the hook that way.

Or suppose that the plan fiduciaries in a particular case think that their investment consultant is a real ERISA section 3(21) fiduciary. Well, maybe the consultant is and maybe it's not. But if a participant lawsuit ensues and the contract in question makes clear that the consultant is a phantom fiduciary, then the consultant has a strong argument in saying that because it doesn't have any discretionary authority or control, or that it hasn't rendered ERISA-defined "investment advice," then it isn't a real fiduciary. After all, the contract shows that the process of providing a list of managers based upon generic criteria is in no way connected to the specifics of the retirement plan. Since it's generic in nature, it's incidental in nature. So it becomes a game of finger-pointing to prove what that "wink, wink" really meant.

But why have to go through all the cost and time of proving what actually happened? Why not just have a written contract that spells out duties clearly (so plan fiduciaries don't have to rely on the hope that they'll win the "she said, he said" argument) and then act in conformance with those written duties? The alternative, way too often, is the specter of an investment consultant spouting the word "fiduciary" yet who doesn't actually have to act like one because its contract says that it isn't one.

Without a decent contract to protect plan fiduciaries, investment consultants from the dark side can get away with a lot which is exactly why such consultants are always happy to provide plan fiduciaries with all kinds of wonderful "pseudo-help." But those consultants won't assume any real fiduciary responsibility (and, therefore, liability) as an ERISA section 3(38) "investment manager" and ERISA section 405(d)(1) "independent fiduciary" so that plan fiduciaries can actually benefit from some real help.

In many cases, of course, the consultants that pooh-pooh the significance of adding real value through assumption of 3(38)/405(d)(1) fiduciary responsibility are the very same ones that won't ever step up and assume same: Well okay, if it's no big deal, why don't you just sign a contract legally requiring you to assume such duties and actually help your plan fiduciaries? We know the answer to that is a simple one. Such consultants--fiduciaries in name only--are absolutely terrified of assuming any real fiduciary responsibility and corresponding liability. They have hidden that terror very well by creating a giant artifice that is designed to hoodwink people.

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