Thought Leadership for
Retirement Plan Executives
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Hiring investment advisors: which type is best 3(21) or 3(38)?

In order to differentiate their practices, some investment consultants are starting to promote themselves as ERISA Section 3(38) investment managers.

Unlike the traditional retirement plan investment consulting role, which is embraced by ERISA Section 3(21), a 3(38) assumes **discretionary control** for some or all of a plan's assets.

While a plan sponsor's appointment of a 3(38) does not transfer policy discretion or monitoring responsibilities, the investment decisions under this structure are made **without the approval of the plan sponsor and/or its internal fiduciaries**.

Similar to the selection of any service provider, the plan sponsor must employ and document a prudent process for the selection of the 3(38) investment manager. If the 3(38) lacks proper experience and corresponding performance as a discretionary investment manager, the decision to retain its services <u>could be deemed imprudent</u>.

The skill sets applicable to investment consulting and investment management differ greatly. Generally speaking, investment consultants, whose experiences are more or less restricted to researching mutual funds, are far less skilled than investment management companies that buy and sell the securities that comprise the mutual funds.

Consultants who become engaged by a plan sponsor as 3(38)s, without a corresponding change in their competency and support services, **escalate exposure to the risk of litigation for themselves and their clients.**

Many legal experts do not believe ERISA Section 3(38) was intended to apply to consultants. That has not stopped many from annointing themselves as such, however, in order to gain new clients.

Keys to Supply Chain Management

Managing the inherent risks of an ERISA plan's supply chain requires the systematic identification, assessment, and reduction of the hazards caused by vendors that do not share equally in the sponsor's legal duty.

The objectives of an ERISA supply chain risk management program include:

- Counteract vendors' incentives to build and maintain an information advantage over executives that buy pension services;
- Detect predatory pricing schemes;
- Ensure that services contracted are actually received;
- Validate vendors' co-fiduciary claims;
- Identify conflicts of interest in the incumbent vendors' business models and determine if they are acceptable;
- Confirm independently that vendors' services actually qualify a plan's fiduciaries for relevant "safe harbors" such as relief from investment liability under ERISA Section 404(c); and
- Support certification of the plan sponsor's compliance with the **Fee Disclosure Rule** contained in ERISA Section 408(b)(2).

If you are uncertain about how to decide the benefits of hiring an 3(21) advice only investment firm versus a 3(38) investment manager, ask Roland|Criss.

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