401(k) Plan Investment Managers
Legal and Practical Considerations

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I. Background

With the rise of fiduciary litigation[1] against 401(k) plan sponsors and sponsor-affiliated investment committees and the elimination of the "*Moench* presumption" by the Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S.Ct. 2459 (2014), more 401(k) plan administrators are considering delegating complete investment responsibility for the selection and retention of investment options (including company stock funds) to investment managers, otherwise known as "3(38) fiduciaries." While delegations to investment managers are common with respect defined benefit plans and 401(k) plan separate accounts (also known as "white label" funds), such delegations are still relatively unusual with respect to company stock and the selection and monitoring of all or substantially all 401(k) plan investment options.

The purpose of this outline is to describe the legal distinctions between 3(38) "investment managers" and 3(21) "consulting fiduciaries" in the context of defined contribution plan fund selection and monitoring, including relevant case law relating to co-fiduciary liability as well as practical implications, including investment policy statements, service agreements, and monitoring and reporting obligations and practices.[2]

II. Investment Managers (3(38)) vs Investment Advisors (3(21)

A. 3(21) Fiduciaries. Every acting fiduciary[3] of an ERISA plan is a "3(21) fiduciary." Section 3(21) simply defines the types of authority, responsibility, or conduct that makes a person a "fiduciary" for purposes of ERISA. The test of fiduciary status under section 3(21) of ERISA is functional and does not depend upon a particular title or a written delegation or acknowledgement. *Arizona State Carpenters Pension Trust Fund v. Citibank*, 125 F.3d 715 (9th Cir. 1997) (comparing and contrasting named fiduciaries, investment

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[1] See Reilly, *Plan Expense Litigation, Are We Done?*, ERISA Industry Group of Houston, Sept. 13, 2016.

[2] This outline does not address "eligible investment advice arrangements" under section 408(g) of ERISA, which provides a prohibited transaction exemption for investment advice and related fees and transactions in connection with individual investment advice provided to plan participants using computer models or level fee arrangements. Those arrangements start with funds already selected by plan trustees, named fiduciaries, or investment managers.

[3] Some persons are ERISA fiduciaries not because of their conduct, responsibilities, or authority, but simply because they are named as fiduciaries in the plan or trust document. See ERISA §§ 402(a) (relating to named fiduciaries) and 403(a) (trustees). Even if such persons do not exercise any discretionary authority or responsibility, they are still considered plan fiduciaries. See, e.g., ERISA § 3(14)(A) (including trustees as fiduciaries for purposes of the "party in interest" definition); EBSA Reg. § 2509.75-8, Q&A-D-3.

managers, trustees, and 3(21) "other" fiduciaries and concluding that the plan custodian Citibank was neither a delegated fiduciary nor a functional fiduciary).

1. Statutory Definition. ERISA section 3(21)(A)[4] provides, in pertinent part, as follows:

> (21) (A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders 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 (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 405(c)(1)(B) [i.e., a person to whom fiduciary responsibilities are delegated by a named fiduciary].

2. Common Arrangements for 401(k) Plans. Investment advisors who are 3(21) fiduciaries are typically retained by 401(k) plan trustees, named fiduciaries, and their fiduciary delegates as consulting fiduciaries to provide advice with respect to the selection and monitoring of plan investment options. The advisors are typically retained in situations in which the named fiduciary or trustee (or a fiduciary delegate of either) does not have the requisite expertise to satisfy the prudence requirement of ERISA section 404(a)(1)(B), which evaluates prudence based on the reasonable care and skill of an expert. Because the 3(21) fiduciary is not ultimately responsible for selecting and retaining investment options, advisory agreements with such fiduciaries typically require the trustee, named fiduciary, or fiduciary delegate retaining the advisor to retain full liability for investment decisions subject only to the advisor's responsibility for its own fiduciary breaches (i.e., bad advice) under ERISA.

B. 3(38) Investment Managers. An investment manager is a 3(21) fiduciary who satisfies two additional requirements: status (registered investment adviser, bank, or insurance company)[5] plus written acknowledgement of fiduciary status.[6] The statute

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[4] Section 3(21)(B) of ERISA provides an exception from fiduciary status for certain investment company (i.e., mutual fund) managers and advisers, an exception that is effectively incorporated through the "plan asset" rules for such funds.

[5] A court appointed investment manager (to remedy harm caused by a fiduciary breach) need not be a registered investment adviser. See *Katsaros v Cody*, 744 F.2d 270 (2d Cir. 1984), *cert den. sub nom Cody v Donovan*, 105 S.Ct. 565 (1989).

[6] If responsibility is delegated to a fiduciary who lacks the requisite status and/or who does not provide the required written acknowledgement, then ERISA section 405(d)(1) does not protect a

includes a nominal third requirement of power/authority to manage, acquire, or dispose of plan assets, but that requirement is inherent within the assumed 3(21) fiduciary status.

1. Statutory Definition. ERISA section 3(38) provides as follows:

> (38) The term "investment manager" means any fiduciary (other than a trustee or named fiduciary, as defined in section 402(a)(2))—
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> (A) who has the power to manage, acquire, or dispose of any asset of a plan;
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> (B) who (i) is registered as an investment adviser under the Investment Advisers Act of 1940 (the "'40 Act"); (ii) [is a pension consultant not registered under the '40 Act but registered under State law with a copy of such registration provided to the Department of Labor]; (iii) is a bank, as defined in [the '40 Act]; or (iv) is an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State; and
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> (C) has acknowledged in writing that he is a fiduciary with respect to the plan.

2. Who May Appoint an Investment Manager? The statute provides that only a named fiduciary with respect to the control or management of plan assets may appoint an investment manager. ERISA § 402(c)(3). However, one court has held that the fiduciary delegate of a named fiduciary may appoint an investment manager. See *Harley v. Minnesota Mining & Mfg. Co.*, 42 F. Supp. 2d 898, 908 fn. 13 (D. Minn. 1999), *aff'd sub nom.* 284 F. 3d 901 (8th Cir. 2002) (noting that ERISA section 405(d)(1) would apply to relieve the plan sponsor 3M and its delegate, the "Pension Asset Committee," from liability for the actions of the investment manager appointed by the Pension Asset Committee, but not from liability for monitoring such investment manager). Because of the limited case law on this point, a conservative approach would be to require investment manager appointments to be made solely by named fiduciaries (and even better, given the limitations of ERISA section 405(d)(1) described below, solely by trustees at the direction of named fiduciaries).

3. Responsibility of Investment Managers; Formalities. If a plan permits named fiduciaries to delegate their responsibilities, the responsibility for managing or controlling plan assets (i.e., "trustee responsibilities" as defined by section 405(c)(3) of ERISA) may only be delegated to an investment manager.[7]

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trustee (or other fiduciary) from co-fiduciary liability for breaches committed by the putative (but failed) investment manager. *Whitfield v. Cohen*, 682 F. Supp. 188 (S.D.N.Y. 1988).

[7] Absent such a delegation to an investment manager or a provision making the trustee a directed trustee subject to the control of another named fiduciary, the responsibility for managing and

ERISA § 405(c)(1); EBSA Reg. § 2509.75-8, Q&A-FR-15. Therefore, ultimate responsibility for managing or controlling the investment of plan assets may not be delegated to a 3(21) fiduciary who is not qualified to be an investment manager or who does not acknowledge fiduciary status in writing. *See Chesemore v. Alliance Holdings, Inc.*, 2012 WL 3041950 (W.D. Wis.) (holding that a delegation of responsibility to an investment advisor (not an investment manager) in connection with an ESOP transaction was not effective under ERISA section 405(c)(1), and therefore the trustees were not relieved from liability for following the instructions of the investment advisor); *McManus & Pellouchoud, Inc. Employees' Profit Sharing Trust v. L. F. Rothschild, Unterberg, Towbin*, 1989 WL 100103 (N.D. Ill. 1989) (ruling on summary judgment that that plan trustees, rather than broker/advisor, were responsible for investment losses of profit sharing plan because broker/advisor did not provide written acknowledgment of its fiduciary status as an investment manager and therefore the delegation of "trustee responsibilities" failed); *Schetter v. Prudential-Bache Securities Inc.*, 695 F. Supp. 1077(E.D. Cal. 1988) (ruling the same after a trial). The investment management agreement must formally document the fiduciary appointment and acknowledgement of the investment manager. When the initial agreement did not delegate investment management responsibility to a custodian, an alleged subsequent delegation that was not documented is not effective to make the custodian an investment manager or fiduciary liable for breaches committed by a separate investment manager. *Arizona State Carpenters Pension Trust Fund v. Citibank*, 125 F.3d 715 (9th Cir. 1997) (terms of custodial agreement did not delegate fiduciary duties or independent authority or managerial responsibility for trust assets and therefore custodian Citibank was not a fiduciary responsible for breaches committed by separate investment manager).

C. Why Does it Matter? Co-Fiduciary Liability. If investment responsibility is delegated to a Section 3(38) investment manager, co-fiduciary liability for other plan fiduciaries is limited. ERISA section 405 describes the circumstances in which a fiduciary may have liability for a co-fiduciary's breach of fiduciary duty. Section 405 contains a general rule as well as special rules for trustees, investment managers, and fiduciaries to whom responsibility is allocated by a plan document or delegated by another fiduciary in accordance with plan procedures. However, as explained below, the only real limitations on co-fiduciary liability are those for directed trustees, assets held in separate trusts, and investment managers.[8]

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controlling plan assets resides exclusively with the trustee of the Plan. ERISA § 403(a); EBSA Reg. § 2550.403a-1(c).

[8] In addition to the limitations on co-fiduciary liability under section 405, plan fiduciaries may be relieved of liability for individual investment advice provided directly to plan participants by a 3(21) fiduciary advisor under an "eligible investment advice arrangement." See ERISA § 408(g)(10). Such arrangements are beyond the scope of this outline, which is focused on fund selection at the plan level rather than individual participant investment directions.

1. General Rule for Co-Fiduciary Liability.

a. The general rule of co-fiduciary liability in ERISA section 405(a) provides as follows.

> (a) Circumstances giving rise to liability. In addition to any liability which he may have under any other provision of this part, a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:
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> (1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;
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> (2) if, by his failure to comply with section 404(a)(1) in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or
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> (3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

b. ERISA sections 405(a)(1) and (3) require a showing of actual knowledge of the other fiduciary's breach; the law does not impose vicarious liability under these provisions. *In re Enron Corporation Securities, Derivative & ERISA Litigation*, 284 F. Supp. 2d 511 (S.D. Tex. 2003). The elements of a claim brought under ERISA section 405(a)(1), are (1) that a co-fiduciary breached a duty to the plan, (2) that the fiduciary knowingly participated in the breach or undertook to conceal it, and (3) that damages resulted from the breach. *Id.* The plaintiff bears the burden of proof on the first two elements, but the defendant bears the burden of disproving the last element. *Id.* To make a claim under section 405(a)(2) of ERISA, the plaintiff must prove that the fiduciary failed to comply with its duties under ERISA, and thereby enabled a co-fiduciary to commit a breach. *Id.* To make a claim under ERISA section 405(a)(3), the plaintiff must show that the fiduciary had knowledge of the co-fiduciary's breach and that the losses resulted from the co-fiduciary defendant's failure to take reasonable steps to remedy the breach. *Id.*

c. If defendants are found to be liable for breaches by co-fiduciaries, then co-fiduciary liability is joint and several. *Leister v. Dovetail, Inc.*, 546 F.3d 875, 878 (7th Cir. 2008).

d. Co-fiduciary liability applies without regard to the extent of fiduciary responsibility. Thus, a plan sponsor whose sole fiduciary responsibility and authority is to appoint and terminate the plan administrator and plan trustee, will nevertheless be liable for breaches of an appointed fiduciary if any of the conditions of ERISA section 405(a) are satisfied. *Landry v. Air Line Pilot Association International AFL-CIO*, 901 F2d 404 (5th Cir. 1990) ("Moreover, we must stress that although *Sommers* limited the liability of fiduciaries by the "to the extent" language of § 3(21)(A) this limitation does not apply to [Section] 405(a). To illustrate, even if [the union sponsoring the plan] is only found to be a fiduciary "to the extent" of appointing and removing the Plan administrator and Trustee, [the union] may still be liable, for example, for the breaches of [the plan administrator] if [the union] "participat[ed] knowingly in, or knowingly undert[ook] to conceal, an act or omission of [the plan administrator], knowing such act or omission [was] a breach." § 1105(a)(1); *Leigh v. Engle*, 727 F. 2d 113 (7th Cir. 1984). In many stock-drop cases, courts dismiss claims of direct liability (not co-fiduciary liability) against plan sponsors and members of the board of directors on the basis that the fiduciary responsibility of the plan sponsor and board is limited to appointing members of the plan's investment or administrative committee, not overseeing investments. See, e.g., *In re Williams Companies ERISA Litigation*, 271 F. Supp. 2d 1328 (N.D. Oka. 2003); *In re RCN Litigation*, 2006 WL 753149 (D. NJ 2006). In these cases, the claims for direct responsibility are dismissed (because the defendants were not fiduciaries with respect to the alleged misconduct) and are not recharacterized as claims for co-fiduciary liability, presumably because the plaintiffs simply failed to plead the claims under ERISA section 405. Of course, fiduciary and co-fiduciary liability only applies to fiduciaries, so an employer that acts only in a settlor capacity cannot have co-fiduciary liability. *In re Williams Companies ERISA Litigation* (dismissing claims against employer with no fiduciary responsibility under the terms of the plan).

e. If a plaintiff successfully pleads a fiduciary breach claim in connection with an ERISA stock drop case, then related claims of co-fiduciary liability for named fiduciaries (which in some circuits may include the plan sponsor and members of its board of directors if responsible for appointing the plan administrator or plan investment committee) are likely to survive a motion to dismiss. See, e.g., *In re Merck & Co., Inc. Securities Derivative & ERISA Litigation*, 2006 WL 2050577 (D. NJ 2006). Of course, if an underlying claim of fiduciary breach does not survive a motion to dismiss or ruling on summary judgment, then related claims of failure to monitor and co-fiduciary liability under ERISA section 405 will also be dismissed because those claims are completely derivative of the underlying fiduciary breach claims. *See, In re Citigroup ERISA Litigation*, 104 F. Supp. 3d 599 (S.D.N.Y. 2015); *In re BP P.L.C. Securities Litigation*, 866 F. Supp. 2d 709 (S.D. Tex. 2012); *Bunch v. W.R. Grace & Co.*, 532 F. Supp. 2d 283 (D. Mass. 2008) *affirmed* 567 F.3d 1021 (1st Cir. 2009).

2. Special Rule for Trustees. Section 405(b) of ERISA sets forth special rules for co-fiduciary liability in the case of co-trustees of the same trust, trustees of separate trusts under the same plan, and directed trustees.[9]

a. If the assets of a plan are held by two or more trustees, then the general co-fiduciary liability rule applies (notwithstanding the provisions of ERISA section 405(b)(1)(B) permitting the allocation of responsibilities among trustees and relieving a trustee of liability for responsibilities allocated to another trustee). ERISA § 405(b)(2) (stating that the special rule for co-trustees does not "limit any liability that a fiduciary may have under [the general rule of ERISA section 405(a)] or any other provision of [Part 4 of Subtitle B of Title I of ERISA]." Thus the only liability that a co-trustee avoids through the allocation of responsibility to another trustee is liability for breaches of which it is not aware or not responsible through its own breach.

b. If assets of a plan are held in more than one trust, then a trustee is liable only for acts or omissions of the trust with respect to which to which he, she, or it serves as trustee. ERISA § 405(b)(3)(A). A court has extended this principle to hold that a trustee of a funded welfare benefit plan is not responsible for breaches of fiduciary duty committed with respect to a component self-insured medical plan. *NARDA, Inc. v. Rhode Island Hospital Trust National Bank*, 744 F. Supp. 685 (D. Md. 1990). It is not clear whether the multiple trust rule is subject to ERISA section 405(b)(2) (see preceding paragraph above) such that general co-fiduciary liability rules apply to trustees of separate trusts, but the court's discussion of the statutory provisions in *In re Enron Corporation Securities, Derivative & ERISA Litigation* suggests that would be the result.

c. A directed trustee is not liable for following proper directions of a named fiduciary that are made in accordance with the terms of the plan and ERISA. ERISA §§ 405(b)(3)(B); 403(a)(1). The scope of the exemption from ERISA liability for directed trustees is subject to much debate that is beyond the scope of this outline. See DOL Field Assistance Bulletin 2004-03; *In re Enron Corporation Securities, Derivative & ERISA Litigation*, *supra* (concluding that pursuant to ERISA section 405(b)(2) the directed trustee rule in ERISA section 405(b)(3)(B) does not exempt the trustee from the general rule of co-fiduciary liability under ERISA section 405(a)); *In re Delphi Corp. Securities, Derivative & ERISA Litigation,* 602 F. Supp. 2d 810 (E.D. Mich. 2009) (broadly construing ERISA section 405(b)(3)(B) to protect a

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[9] Note that it may be possible to apply these rules to non-trustee fiduciaries who are responsible for managing and controlling plan assets (i.e., "trustee responsibilities" under ERISA section 403(c)(3)). Cf. *Perez v. WPN Corp.,* 2017 WL 2461452 (W.D. Penn. 2017) (applying the exemption from co-fiduciary liability for a trustee who appoints an investment manager to a non-trustee fiduciary who has trustee responsibilities and delegates those to an investment manager).

directed trustee from fiduciary breach claims when the trustee followed the instruction of a named fiduciary).

3. Special Rule for Allocated and Delegated Fiduciary Responsibilities. The special rule for allocated and delegated fiduciary responsibilities provides rules for such allocations and delegations, but does not further limit the application of the general rule for co-fiduciary liability.

a. ERISA section 405(c)(1) of ERISA allows a plan to expressly provide for procedures for allocating fiduciary responsibilities (other than "trustee responsibilities") among named fiduciaries and for named fiduciaries to designate persons other than named fiduciaries to carry out fiduciary responsibilities (other than trustee responsibilities). If a plan does not contain procedures permitting the delegation of fiduciary responsibility, then any such delegation does not relieve the delegating fiduciary for any responsibility for the actions and omissions of the fiduciary to whom responsibility is delegated. *Brock v. Self*, 632 F. Supp. 1509 (W.D. La. 1986).

i. For this purpose, "trustee responsibility" means any responsibility provided in the plan's trust instrument to manage or control the assets of the plan, other than a power under the trust instrument of a named fiduciary to appoint an investment manager in accordance with ERISA section 402(c)(3). ERISA § 405(c)(3).

ii. As indicated above in Section II.B.3 of this outline, "trustee responsibilities" may not be allocated or delegated to any fiduciary other than an investment manager.

b. If a plan contains such procedures and non-trustee fiduciary responsibility is allocated or delegated pursuant to the procedures, then ERISA section 405(c)(2) provides that the named fiduciary whose responsibility was allocated or delegated shall not be liable for an act or omission of the fiduciary carrying out such responsibility except to the extent that

i. the named fiduciary violated its fiduciary duties with respect to such allocation or designation, with respect to the establishment or implementation of the procedure for allocating or delegating fiduciary responsibilities, or in continuing the allocation or designation (ERISA § 405(c)(2)(A)); or

ii. the named fiduciary would otherwise be liable in accordance with ERISA section 405(a) (the general rule for co-fiduciary liability). ERISA § 405(c)(2)(B).

Although ERISA § 405(c)(2)(A) would limit responsibility to the initial delegation/allocation and ongoing monitoring, ERISA § 405(c)(2)(B) applies the general rule. Thus, for example, a fiduciary which has delegated responsibility to another fiduciary and satisfied its obligations to appoint and

monitor the other fiduciary nevertheless remains liable for a fiduciary breach committed by the other fiduciary if the delegating fiduciary is aware of the breach and fails to take reasonable action to remedy the breach. *Willett v. Blue Cross & Blue Shield*, 953 F.2d 1335, 1341 (11th Cir. 1992) (ruling that "[a] fiduciary who becomes aware that a co-fiduciary has breached a fiduciary duty to plan beneficiaries may not escape liability by simply casting a blind eye toward the breach"). A delegating fiduciary is also responsible for the prudent selection and monitoring of the fiduciary that accepts the delegation. ERISA § 405(c)(2)(A); *Leigh v. Engle, supra*. Thus the only liability that a delegating fiduciary avoids is liability for breaches of which it is not aware and that it could not discover through prudent monitoring.

4. Special Rule for Investment Managers. The appointment of an investment manager exempts trustees (and possibly other fiduciaries as described below) from co-fiduciary liability with respect to assets managed by the investment manager even in situations in which (i) they know of a breach by the investment manager and fail to remedy it and/or (ii) they enable an investment manager to commit a breach due to their own breach of fiduciary duty (such as a failure to monitor). ERISA§ 405(d)(1); *Beddall v. State Street Bank and Trust Company*, 137 F.3d 12 (1st Cir. 1998). Section 405(d) of ERISA provides as follows:

> (d) Investment managers.
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> (1) If an investment manager or managers have been appointed under section 402(c)(3), then, notwithstanding subsections (a)(2) and (3) and subsection (b) [relating to the special rules for co-fiduciary liability of trustees], no trustee shall be liable for the acts or omissions of such investment manager or managers, or be under an obligation to invest or otherwise manage any asset of the plan which is subject to the management of such investment manager.
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> (2) Nothing in this subsection shall relieve any trustee of any liability under this part for any act of such trustee.

a. The exemption from co-fiduciary liability under ERISA section 405(d)(1) is subject to some important limitations.

i. Trustees (and other fiduciaries) remain liable for their own breaches of fiduciary duty. ERISA § 405(d)(2). Thus, a trustee who has delegated investment responsibility to an investment manager remains liable for its own breach of fiduciary duty if it fails to adequately monitor the investment manager. *Solis v. Webb*, 2012 WL 4466536 (N.D. Cal. 2012). Similarly, the delegation of responsibility to an investment manager does not protect a fiduciary from fiduciary breach claims relating to the information it discloses or fails to disclose (i.e., misrepresentation claims). *See, e.g., In re HP*

ERISA Litigation, 2014 WL 1339645 (N.D. Cal. 2014) (rejecting a defense[10] to misrepresentation claims based on the delegation of company stock fund responsibility to an investment manager, State Street Bank); *Ramirez v. J.C. Penney Corp. Inc.*, 2015 WL 5766498, (E.D. Tex. 2015) (same); *Barry v. Trustees of the Int'l Assoc. Full-Time Salaried Officers and Employees of Outside Unions and District Counsel's (Iron Workers) Pension Plan*, 2005 WL 3276313 (D. DC 2005) (ruling that ERISA section 405(d)(1) does not protect a fiduciary from a claim that the fiduciary failed to disclose material information to an investment manager).

ii. The exemption from co-fiduciary liability does not apply to claims under ERISA section 405(a)(1). Therefore, trustees (and other fiduciaries have co-fiduciary liability if they knowingly participate in or knowingly act to conceal a breach of fiduciary duty by an investment manager. *Solis v. Webb*, *supra* (refusing to dismiss claims that plan trustees were responsible for fiduciary breaches committed by an investment manager when they knowingly followed the manager's imprudent direction to invest in company stock in connection with an ESOP transaction). To minimize "knowing participation" claims, plan fiduciaries who have delegated responsibility to investment managers should not act as middlemen in relaying instructions from the investment managers to trustees and custodians. Note the obvious tension between prudently monitoring an investment manager and not being actively involved in the manager's investment decisions.

b. By its terms, the exemption from co-fiduciary liability in section 405(d)(1) of ERISA applies only to trustees. However, two lower courts have held that the exemption also applies to fiduciaries (such as plan investment committees and plan sponsors) that otherwise would have investment responsibility that is delegated to an investment manager. *Perez v. WPN Corp.* 2017 WL 2461452 (W.D. Penn. 2017); *Harris Trust & Sav. Bank v. Salomon Bros.*, 832 F. Supp. 1169 (N.D. Ill. 1993). The decision in *Perez v. WPN Corp.* includes an extensive analysis of the statute (including the definition of "trustee responsibility" in ERISA section 405(c)(3)), legislative history, and dicta in other cases in reaching its conclusion. Although the decisions are persuasive, a conservative practice would be for trustees to appoint investment managers (at the direction of another named fiduciary if the trustee is a directed trustee) and then delegate monitoring responsibility to another fiduciary (if the trustee is a directed trustee).

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[10] Although the defense was rejected, the misrepresentation claims (against the plan sponsor, its in-house asset manager, and key employees who were named fiduciaries) were rejected because plaintiffs had not claimed that the plan fiduciaries were aware of alleged falsities in future SEC filings at the time an SPD (that incorporated those filings) was published.

c. The rule precluding exculpatory contracts does not apply to the exemption from co-fiduciary liability in section 405(d) of ERISA. ERISA § 410(a) ("Except as provided in sections 405(b)(1) and 405(d) of this title, any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part shall be void as against public policy.") Therefore, investment management agreements that relieve fiduciaries (other than the investment manager) from co-fiduciary liability are not void under ERISA section 410.

D. Summary. The court in *Lowen v. Tower Asset Management* summarized the foregoing as follows:

> ERISA was deliberately structured so that legal responsibility for management of ERISA plans would be clearly located. ERISA Section 402(1) thus directs that every plan designate a “named fiduciary” with power “to control and manage” the plan. Congress included this requirement “so that responsibility for managing and operating the Plan—and liability for mismanagement—are focused with a degree of certainty.” The obligations of named fiduciaries with regard to their duty of care, however, can be reduced by the appointment of an investment manager under ERISA Section 402(c)(3). Under Section 405(d)(1), once such an appointment has been made, the trustees cannot be held liable for any act or omission of that investment manager so far as the assets entrusted to the manager are concerned. The plain intent of this statutory structure is to allow plan trustees to delegate investment authority to a professional advisor who then becomes a fiduciary with a duty of care and duty of loyalty to the plan while the trustees' legal responsibilities regarding the wisdom of investments are correspondingly reduced.

829 F. 2d 1209 (2d Cir. 1987) (citations omitted).

III. Practical Considerations

A. Investment Management Agreement.

1. Observe Formalities. As indicated above, the investment management agreement must be written and include a specific acknowledgement of the manager’s fiduciary status. Also, the investment manager must be qualified under ERISA (i.e., be a bank, qualified insurance company, or registered investment advisor), so the delegating fiduciary should confirm qualifications and not just rely on representations by the investment manager. Failure to observe formalities results in co-fiduciary liability for breaches committed by the (failed) investment manager even when the delegating fiduciary prudently selected and monitored the manager. The investment management agreement should require the investment manager to immediately notify the delegating fiduciary if the investment manager ceases to be qualified as an investment manager under ERISA.

2. Clearly Specify Scope of Responsibility (and Amend in Writing when Changes). Courts look to the written investment management agreement to determine the scope of fiduciary responsibility delegated to an investment manager, not the practices of the parties. Thus in the Delphi ERISA litigation, State Street, who was both trustee of the Delphi plan and investment manager of the Delphi and predecessor employer stock funds, was held to be a directed trustee with respect to its management of the stock funds with its authority limited to managing the cash components of the unitized funds even though in practice it evaluated the prudence of remaining invested in such stock and even made the eventual decision to liquidate the stock with the knowledge and participation of the plan sponsor and GM Investment Management Company (the overall investment manager of the Delphi plan). *In re Delphi Corp. Securities, Derivative & ERISA Litigation,* 602 F. Supp. 2d 810 (E.D. Mich. 2009). The court held that the trust agreement, which clearly limited State Street's authority and responsibility to managing the liquidity needs of the company stock funds, and the fund policies, which required the funds to invest primarily in company stock, were controlling because the separate investment management agreements making State Street responsible for managing the funds, were expressly subject to the trust agreement and fund policies. The court ruled that power point presentations and conversations and emails between the plan sponsor and State Street indicating that State Street had the discretionary authority to determine whether to continue to invest in Delphi stock were not sufficient to modify the trust agreement and investment management agreement but instead were construed to be consistent with State Street's authority to sell company stock only in "extraordinary circumstances." For a successful delegation to an investment manager, see *Coburn v. Evercore Trust Co., N.A.*, 2016 WL 7480257 (D.C. Cir. 2016) (claims for breach of fiduciary duty against an employer stock fund investment manager dismissed, but note that separate misrepresentation claims against the delegating plan fiduciaries survived a motion to dismiss, *see Ramirez, supra*).

3. Company Stock Fund Investment Managers. Many plans with company stock funds were amended after *Moench* to add provisions requiring the inclusion of a company stock fund primarily invested in company stock absent a plan amendment or violation of ERISA. See *Moench v. Robertson*, 62 F. 3d 553 (3rd Cir. 1995). Many plans retain that language even after the overturning of the "*Moench* presumption" by the Supreme Court in its *Fifth Third Bancorp* decision, *supra.* Before retaining an investment manager for company stock fund, consider whether *Moench* language will be removed from the plan. If not removed, then the investment manager's responsibility for managing the stock fund may be limited to extraordinary circumstances as was the case for State Street in the GM and Delphi litigation due to the investment manager's fiduciary duty to comply with plan terms to the extent not inconsistent with ERISA. Even if the plan does not include *Moench* provisions, the parties may prefer for the investment manager's authority to be limited to liquidating company stock when the continued holding of such stock would be inconsistent with ERISA (to avoid discretionary liquidations by the investment manager when not otherwise required by ERISA). In either case, depending on the scope of the language the investment manager may be considered a "directed trustee" with respect to the continued holding of company stock similar to State Street in the GM and Delphi litigation. Be careful of "daylight" between the

obligation of the investment manager and of the named fiduciary/trustee who delegated responsibility to the investment manager to minimize the risk of liability for the delegating fiduciary above and beyond the risk imposed on the investment manager. The retention of *Moench* language (or alternatively limiting the investment managers responsibility to determining whether the continued holding of company stock is inconsistent with ERISA) may affect the provisions of the investment management agreement relating to fees and indemnification.

4. Indemnification.

a. For agreements relating to company stock funds, typically the investment manager will require indemnification by the plan sponsor from all claims other than those resulting in a final determination that the manager breached its fiduciary duties, and the indemnity will require current payment of legal fees while litigation is pending. For large plans and independent managers (such as Fiduciary Counselors) not affiliated with a large bank (such as State Street) or service provider (such as Mercer), the investment manager's insurance limit may be less than advanced fees and damages in the event of breach, leaving the sponsor without an effective remedy for recouping advanced fees in the event of breach. Because of the indemnification commitment, the sponsor is effectively buying a potential increased likelihood of success on the merits (with an independent fiduciary determination) and the exemption from co-fiduciary liability (in the event of a breach by the investment manager without a related failure to monitor breach by the delegating fiduciary) rather than avoidance of litigation costs.

b. For agreements delegating fund selection responsibility (excluding company stock) to an investment manager, the indemnity can be negotiated, and typically would not require indemnification of the manager for any claims other than those resulting from the breach of the agreement or applicable law by the delegating fiduciary or plan sponsor. That is, the investment manager typically bears the risk and cost of defending ordinary claims alleging that the manager breached its fiduciary duties under ERISA.

5. Ensure that Investment Responsibility Includes Consideration of Fees. For agreements generally delegating fund selection responsibility (excluding company stock) to an investment manager, make sure that the responsibility for selecting funds and fund managers is absolute so that the manager must take into account not only investment performance but also fees and any other factors that may be relevant to a prudent fiduciary under ERISA.

6. Held Away Assets. Some funds (such as company stock or stable value funds required by the recordkeeper) may be outside of the scope of the delegation of responsibility to an investment manager. Ensure that any such funds are clearly described in the investment management agreement and that the

delegating fiduciary continues to satisfy its fiduciary obligations with respect to those funds.

7. Consent to Evaluations. The investment management agreement should require that the investment manager be available for and cooperate with periodic evaluations by the delegating fiduciary (or its agents or consultants) and provide any information regarding its services or performance as reasonably requested by the delegating fiduciary for purposes of such evaluations.

8. Notice of Fund Changes. To allow the plan administrator to comply with its obligations under the 404(a) regulations (relating to fee and fund performance disclosures), the investment management agreement should require that the manager notify the plan administrator of fund/investment manager changes at least 60 days in advance of the change (or as soon as practicable if such advance notice is not possible due to unforeseeable events or circumstances beyond the control of the investment manager).

9. Fees. For company stock fund investment managers, the fee will typically be negotiated as a fixed amount (plus certain expenses, which may include legal fees and fees for serving as a witness) rather than a percentage of assets in the stock fund (the basic work to be performed is the same without regard to the amount of assets in the fund). For global investment managers responsible for selecting all investment options in a plan, the fee will typically be negotiated as a percentage of assets, subject to maximum and minimum fees. Depending on plan size, managers may be willing to negotiate fixed fees for global investment management responsibility.

B. Investment Policy Statements (IPS). Typically the investment management agreement will require the investment manager to comply with the plan's IPS (if any).

1. IPS with Global Investment Manager. For global managers responsible for selecting all of a plan's investment options, the IPS should not specify asset classes or metrics for evaluating options (that is the job of the investment manager). Instead, specify that the plan administrator and other fiduciaries (other than the investment manager) have no responsibility or authority for monitoring, reviewing, or approving any investment options for assets under the control of the investment manager and limit the substantive parameters of investment options to the following:

a. Options shall include at least one option that constitutes a "qualified default investment alternative" within the meaning of section 404(c)(5) of ERISA and the regulations thereunder.

b. Options shall include a broad range of investment alternatives such that the plan may constitute an "ERISA section 404(c) plan" within the meaning of section 404(c) of ERISA and the regulations thereunder.

c. Options shall permit investment instructions by plan participants with a frequency consistent with the plan and the provisions of section 404(c) of ERISA.

2. IPS with Company Stock Fund Investment Manager. The IPS provisions relating to the stock fund will depend on whether the plan document retains *Moench* language and the scope of authority delegated to the investment manager (complete discretion to remove or limit stock fund vs authority limited to removing stock fund if no longer consistent with ERISA).

C. Monitoring of Investment Managers.

1. General Legal Standard. Under ERISA, a fiduciary who appoints or delegates responsibility to another fiduciary has a duty to appropriately monitor the fiduciary. *Leigh v. Engle*, 727 F. 2d 113 (7th Cir. 1984). The purpose of the monitoring is to determine whether the appointed fiduciary is fulfilling his fiduciary obligations. *Baker v. Kingsley*, 387 F.3d 649 (7th Cir.2004). The Department of Labor (DOL) has provided only limited guidance as to what is required to satisfy the duty to monitor. In regulations issued shortly after ERISA was enacted, the DOL explained that

> At reasonable intervals the performance of trustees and other fiduciaries should be reviewed by the appointing fiduciary in such manner as may be reasonably expected to ensure that their performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan. No single procedure will be appropriate in all cases; the procedure adopted may vary in accordance with the nature of the plan and other facts and circumstances relevant to the choice of the procedure.

In Field Assistance Bulletin 2007-01, the DOL explained as follows in the context of a fiduciary retained to provide investment advice directly to participants under the Pension Protection Act's prohibited transaction exemptions for such advice.

> In monitoring investment advisers, we anticipate that fiduciaries will periodically review, among other things, the extent to which there have been any changes in the information that served as the basis for the initial selection of the investment adviser, including whether the adviser continues to meet applicable federal and state securities law requirements, and whether the advice being furnished to participants and beneficiaries was based upon generally accepted investment theories. Fiduciaries also should take into account whether the investment advice provider is complying with the contractual provisions of the engagement; utilization of the investment advice services by the participants in relation to the cost of the services to the plan; and participant comments and complaints about the quality of the furnished advice. … to the extent that a complaint or complaints raise questions concerning the quality of advice being provided to

> participants, a fiduciary may have to review the specific advice at issue with the investment adviser.

Finally, in an amicus brief submitted in connection with the Williams ERISA litigation, *supra*, the DOL provided a little more detail regarding what it believes is required (and also what is not required) to satisfy the duty to monitor.

> [T]he appointing fiduciaries are not charged with directly overseeing the investments and thus duplicating the responsibilities of the investment fiduciaries. But they are required to have procedures in place so that on an ongoing basis they may review and evaluate whether the investment fiduciaries are doing an adequate job. Appointing fiduciaries are not directly responsible for management of the plan's portfolio; they simply have the responsibility of effectively reviewing their appointees' performance to ensure that they are doing their job (for example, by requiring periodic reports on their work and the plan's performance, and by ensuring that they have a prudent process for obtaining the information and resources they need). The important point is not that the appointing fiduciaries must follow one prescribed set of procedures for monitoring the investment fiduciaries, but that they apply procedures that allow them, under the applicable circumstances, to assure themselves that those they have entrusted with discretionary authority to invest the plan's assets are properly discharging their responsibilities. (citations omitted)

In re Williams Co. ERISA Litigation, No. 02-153 (N.D. Ola. Aug 22, 2003) (DOL Amicus Brief, attached as Ex. A to Def. Supp. Br.). A court synthesized the foregoing DOL guidance and applicable case law as requiring the following actions by an appointing fiduciary to satisfy its monitoring obligation under the applicable facts and circumstances:

- the appointing authority must adopt routine monitoring procedures;
- the appointing authority must adhere to the routine monitoring procedures;
- the appointing authority must review the results of the monitoring procedures;
- the monitoring procedures must alert the appointing authorities to possible deficiencies; and
- the appointing authority must act to take required corrective action.

Perez v. WPN Corp. 2017 WL 2461452 (W.D. Penn. 2017).

2. Procedures. The court in *Perez* and the DOL guidance emphasize the need for monitoring procedures. Relatively simply procedures (included in the appointing fiduciary's charter or investment policy statement) requiring annual or more frequent (as warranted by the circumstances) review of a manager's

performance; credentials; and compliance with the Plan, investment management agreement, and investment policy statement should suffice to satisfy this requirement.

3. Frequency. How frequently does the appointing fiduciary need to review the conduct of the investment manager to satisfy its duty to monitor? In *Perez*, the court stated that "a standard of reasonableness" applies, and that the appointing fiduciary must ascertain within a reasonable time whether the delegate is properly carrying out his responsibilities. The DOL guidance similarly requires monitoring at "reasonable intervals." A common practice of plan fiduciaries who have not delegated investment management responsibility is to meet quarterly to review investment options, and such options are not likely to change more frequently than quarterly given the time needed to implement and notify participants of changes. Given the DOL's statement in its amicus brief that monitoring fiduciaries "are not charged with directly overseeing the investments and thus duplicating the responsibilities of the investment fiduciaries" a comprehensive review once per year should be sufficient if the manager's investment review occurs once per quarter. But the court in *Perez*, while stating that continuous monitoring, is not required, faulted the monitoring fiduciaries for taking 58 days to discover that investments were undiversified and an additional 83 days to correct the failure. So while a formal performance review of the investment manager might occur once per year, the monitoring fiduciary will need to review reports of significant changes in investments as they occur. (Note the difficulty of satisfying this standard in the context of monitoring the manager of a company stock fund during a period of rapid price declines or volatility.) The monitoring fiduciary should also require the investment manager to immediately notify the monitoring fiduciary if the manager's credentials fail to satisfy requirements of the investment management agreement (e.g., loss of a securities license) or if the manager is under investigation by the SEC or applicable banking or insurance authorities. If the appointing fiduciary receives such a notice it should meet immediately to review the continued retention of the manager.

4. Scope. At a minimum, the monitoring fiduciary's review of the investment manager should include review of credentials (e.g., that the manager is still a registered investment advisor, if applicable) and compliance with the terms of the plan, investment management agreement, and investment policy statement (as applicable). The harder question is what is required to review the "performance" of the manager. The DOL's amicus brief in the Williams litigation indicates that the review does not require direct oversight (or second guessing) of investment decisions. Instead, the focus of the performance review should be on assessing whether the manager has a prudent process for reviewing investment options and collecting relevant information. In my experience, investment manager reports by both global and employer stock managers too frequently resemble the reports provided by a consulting fiduciary, as if the monitoring fiduciary was the ultimate fiduciary responsible for investment decisions. For example, the reports frequently contain "recommend" language which implies that the monitoring fiduciary is ultimately responsible for approving or ratifying the manager's investment management decisions. Reports also frequently list all information reviewed by the manager (e.g., in the case of an employer stock fund manager, all SEC filings, analysts reports,

credit reports, press releases, and significant litigation), effectively imposing an obligation on the monitoring fiduciary to correct inaccurate or incomplete information. These types of reports are likely to steer discussion during the performance review to an analysis of individual decisions (and invite second guessing of the decisions). Instead, the reports should list the manager's decisions, include a general description of the information reviewed in making the decisions, describe the process by which the manager makes investment decisions, and state whether the process was followed in reaching the manager's actual investment decisions. Questions for the investment manager should focus on compliance with the prudent process.

Investment Policy Statement

[Company] 401(k) Plan

Purpose of the Plan

[insert name of company] (the “Plan Sponsor”) sponsors the *[insert plan name]* (as amended, the “Plan”). The purpose of the Plan is to provide a tax-deferred retirement program for eligible employees of the Plan Sponsor and its participating affiliates.

The Plan is a tax-qualified defined contribution plan that provides for benefits based solely on the amount contributed to each participant’s account, plus or minus any income, expenses, investment gains/losses and forfeitures. The Plan is administered by the administrator designated pursuant to the terms of the Plan (including any successor, the “Plan Administrator”). As of *[insert applicable date]*, the Plan Administrator is the *[insert name of benefits committee or other plan administrator]*. The trustee of the Plan as of *[insert applicable date]* is *[insert name of trustee]* (including any successor, the “Trustee”).

Plan participants may direct the investment of their accounts under the Plan from among available investment options under the Plan (the “Investment Options”). The Plan Sponsor and Plan Administrator intend for the Plan to satisfy, and the Plan shall be administered to satisfy, the requirements of Section 404(c) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”).

Delegation of Investment Responsibility and Authority

The [Plan Administrator and/or Trustee [as applicable] has/have] appointed and delegated [its/their] authority and responsibility to *[insert name of investment manager]* (the “Investment Manager”) to act as a “fiduciary” (within the meaning of section 3(21) of ERISA) and an “investment manager” (within the meaning of section 3(38) of ERISA) with the full discretionary authority to manage, acquire, and dispose of certain assets of the Plan (the “Discretionary Assets”) as specified in a written agreement between the [Plan Administrator and/or Trustee [as applicable]] and the Investment Manager (the “Investment Agreement”). The [Plan Administrator and/or Trustee [as applicable] has/have] also appointed the Investment Manager to act as a “fiduciary” (within the meaning of section 3(21) of ERISA) with respect to certain other assets of the Plan (if any, the “Consulting Assets”) as specified in the Investment Agreement. The Investment Manager has agreed in the Investment Agreement to accept such authority and responsibility and to comply with this Investment Policy Statement as amended from time to time (this “Investment Policy”).

Purpose of Investment Policy Statement

The purpose of this Investment Policy is to define certain criteria that the Investment Manager must satisfy with respect to the Discretionary Assets and to generally describe the Plan Administrator’s policies regarding review and monitoring of the Investment Manager, of the Consulting Assets, and of the assets of the Plan other than the Discretionary Assets and the Consulting Assets (the “Held-Away Assets”).

All decisions regarding the investment of Plan assets shall be made in accordance with the terms of the Plan (except as otherwise required by ERISA), in the sole interest of Plan participants and beneficiaries, and for the exclusive purpose of providing benefits to Plan participants and defraying the reasonable expenses of administering the Plan. The Plan’s assets must be invested with the care, skill, and diligence that a prudent investor acting in this capacity would use to comply with ERISA.

The Plan Administrator shall have full and sole authority to interpret all of the provisions of this Investment Policy and to resolve all questions concerning this Investment Policy and its application.

In meeting its responsibilities as described herein, the Plan Administrator may delegate responsibility to other capable parties such as management staff, investment consultants or other service providers. To the extent that fiduciary responsibility for any of the above is delegated to a third party, the third party shall fulfill its fiduciary responsibilities in accordance with the Plan, this Investment Policy, applicable agreements with the third party, and applicable law.

None of the Plan Sponsor, the Plan Administrator, or any other Plan fiduciary provides investment advice to any participant or assists any participant in deciding how to allocate contributions to the participant's individual investment accounts. No Plan fiduciary shall be responsible for any financial loss that may be incurred by any participant as a result of the participant's investment direction or decisions (including a default election) or as a result of any action taken in accordance with the participant's directions or default elections with respect to the investment or administration of his/her Plan account. This Investment Policy does not provide any additional rights to any Plan participant or beneficiary.

Discretionary Asset Investment Options

The Investment Manager shall select and monitor Investment Options for the Discretionary Assets in accordance with ERISA and all other applicable laws and in accordance with this Investment Policy, including the second paragraph of the "Purpose of Investment Policy Statement" section above. The Investment Options for the Discretionary Assets

- shall include at least one option that constitutes a "qualified default investment alternative" within the meaning of section 404(c)(5) of ERISA and the regulations thereunder;

- shall include a broad range of investment alternatives such that the Plan may constitute an "ERISA section 404(c) plan" within the meaning of section 404(c) of ERISA and the regulations thereunder; and

- shall permit investment instructions by Plan participants with a frequency consistent with the Plan and the provisions of section 404(c) of ERISA.

The Investment Manager shall notify the Plan Administrator at least sixty (60) days in advance of adding, modifying, or deleting any Investment Option or the performance benchmark(s) for such option such that the Plan Administrator may satisfy its notice obligations under section 404(a) of ERISA.

The Plan Administrator shall have no responsibility or authority for monitoring, reviewing, or approving any of the Discretionary Asset Investment Options.

[Note: depending on scope of Consulting Asset and Held Away Asset Investment Options, additional detail may be required to describe parameters of the investment of such assets. This example assumes that the Consulting Asset Investment Option is limited to a stable value fund

required to be included as a plan investment option by the recordkeeper and that the Held Away Asset Investment Option is limited to an employer stock fund.]

Plan Administrator Responsibilities

The Plan Administrator shall at least once per year and at such other times, if any, as are appropriate under circumstances as it shall determine in its sole discretion:

- Evaluate the credentials and performance of the Investment Manager as investment manager of the Discretionary Assets and investment consultant of the Consulting Assets (including evaluating compliance with the terms of the Plan, the Investment Agreement, and this Investment Policy) and take any appropriate action under the Investment Agreement, including terminating or modifying such agreement and the delegation of fiduciary responsibility thereunder;

- Evaluate the performance of the Consulting Asset Investment Options with the advice and guidance of the Investment Manager and add, eliminate, or modify such Consulting Asset Investment Options as appropriate; *[Note: depending on the scope of Consulting Asset Investment Options, additional detail may be desirable.]*

- Evaluate the performance of the Held-Away Asset Investment Options and add, eliminate, or modify such Held-Away Asset Investment Options as appropriate; and *[Note: depending on the scope of Held-Away Asset Investment Options, additional detail may be desirable]*

- Evaluate this Investment Policy with the advice and guidance of the Investment Manager and adopt any amendments to this Investment Policy at any time as it determines in its sole discretion.

The Investment Manager shall cooperate with the Plan Administrator, shall meet with the Plan Administrator, and shall provide any information reasonably requested by the Plan Administrator to enable the Plan Administrator to satisfy its obligations under this Investment Policy. The information required to be provided to the Plan Administrator by the Investment Manager includes documentation demonstrating Investment Manager’s compliance with the Plan and this Investment Policy and compliance with ERISA in the performance of its obligations hereunder.