So You Hired an ERISA Â§3(38) Fiduciary â?¦ Now What?

The 2008 and 2009 financial crisis forced many of our clients to streamline and, in many cases, reduce the headcount in their finance and human resources departments. These departments are usually the most involved in the ongoing management and oversight of employee retirement plans. While the economy has improved, we have not yet seen our clients add back the positions eliminated during the downturn to a great extent. Further, human resources and finance professionals have had other things, such as the Patient Protection and Affordable Care Act of 2010, occupying their time. Organizations are doing more with the same amount of people, including the oversight and management of their retirement plans.

Faced with financial market volatility, rising interest rates, regulatory scrutiny, and plan-related litigation activity on the rise, plan sponsors are looking for help managing their plans. In some cases, they are turning to their plan advisors, asking them to do more on their behalf. The result is an increase in plan sponsors engaging advisors in a discretionary capacity to select and monitor plan investments.

Decoding the Numbers

Engaging a professional to provide investment advice has been common for some time among plans subject to the Employee Retirement Income Security Act of 1974 (ERISA). These advisory arrangements are referenced and contracted as *ERISA Â§ 3(21)* engagements, or as some call them co-fiduciary arrangements. This naming convention comes from the section numbers within ERISA itself; Section 3 of ERISA provides term definitions.

The twenty-first item in the list defines a fiduciary. When sponsors engage investment advisors as 3(21) fiduciaries, they hire them to provide investment advice. These advisors are responsible for the analysis, tools, and advice they provide. Although plan sponsors may rely on the advice of their 3(21) investment advisors, the plan sponsors are responsible for any decisions made.

A more recent trend for defined contribution plan sponsors is to engage advisors for discretionary investment management. Doing this requires the investment advisor to contract as an *ERISA Â§ 3(38) fiduciary*. As you may have guessed, this refers to ERISA Section 3â??s thirty-eighth definition. Note that ERISA Â§ 3(38) does not define â??investment advisors with discretion,â?• nor does it say â??hereâ??s a way to transfer more risk to your investment advisor.â?• Rather, it defines *investment managers* as distinct fiduciaries contracted with full discretionary authority over plan investments and making plan investment decisions.

In a defined contribution plan, this means the investment manager may select, monitor, remove, and replace investment options offered to plan participants. An appropriately contracted and executed 3(38) arrangement frees the plan sponsor from the time involved in selecting and monitoring plan investment options and the liability associated with these decisions. As explained in ERISA Â§ 405(d), â??The plan sponsor and/or trustees of the plan are not liable for acts or omissions of the 3(38) investment manager, and are under no obligation to invest or otherwise manage any asset of the plan which is subject to the management of that investment manager.â?• The fact that ERISA outlines this protection makes engaging a 3(38) investment manager an appealing prospect for many plan sponsors.

So Whatâ??s Left to Do?

An ERISA Â§ 3(38) arrangement represents the highest level of investment liability transfer possible under ERISA, but that doesnâ??t mean a plan sponsor has eliminated all investment-related fiduciary duties. As attorney Michael Abbott, an employee benefits partner at Gardere Wynne Sewell LLP, reminds us, â??ERISA Â§ 3(21) covers plan fiduciariesâ??including plan sponsorsâ??to the extent such fiduciaries have any discretionary authority or discretionary responsibility relating to plan management or administration.â?•

But hiring a 3(38) investment manager is not a panacea. Abbott continues: â??While engaging a 3(38) lessens your investment-related responsibilities and risk, it doesnâ??t absolve you completely or allow you to abdicate all investment fiduciary responsibilities.â?• The process of selecting and engaging a 3(38) itself is a fiduciary responsibility.

Engaging a 3(38) investment manager transfers the responsibility and risk associated with the selection and monitoring of the planâ??s investment options. It is critical, however, that plan sponsors realize that even with an appropriately structured 3(38) arrangement, such sponsors â??still have the responsibility to monitor their 3(38) and be aware of the ERISA-related liability associated with hiring, monitoring, and, if needed, replacing them,â?• according to Abbott.

An analogy may help clarify roles. Letâ??s say you bought a new home and are trying to decide how best to move your belongings. Your cheapest option would be to do the move yourself. In doing so, you perform all the work. If anything breaks during the move, there is no one to blame but yourself. You have retained all of the moveâ??s liability.

Another option would be to pay someone to help you load the moving truck. In this scenario, that worker would be responsible for his role in the move. If he dropped a box of your fine china, he would be on the hook for what he damaged. Meanwhile, assuming he didnâ??t poorly pack the china, if the china cracked as you drove the rental truck across town, you would own the liability. Driving the truck was outside the scope of the workerâ??s role.

Finally, you could completely outsource the move by hiring a full-service moving company. Your moverâ??s contract includes an insurance policy to protect your items and removes your liability for broken items. Yet, even in this scenario, you will want to be on site, ensuring the movers do what you instructed them to do, placing boxes in the correct rooms and furniture against the right walls.

Hiring a 3(38) investment manager is like outsourcing your move. While you have outsourced the work and liability, you cannot step away from the process. You must still monitor the investment manager to make sure it is fulfilling its contractual obligations.

Building a Monitoring Framework

When they engage us as a 3(38) investment manager, clients often ask how they should monitor us. We have a unique perspective in answering this question because, in the course of business, we evaluate and monitor the investment managers whose products are present in our clientsâ?? investment lineups. In fact, we have a dedicated team doing this every day, and the rigor we apply to that process influences how we suggest that you monitor a plan-level investment manager.

Below is a handful of questions to consider when creating a framework to monitor a 3(38) investment manager:

Fulfillment of Duties

- *Has the investment manager acknowledged in writing that it is acting as a plan fiduciary?*
- *Is the investment manager adhering to the planâ??s investment policy statement (IPS)?*
- *Is the investment manager selecting plan investment options consistent with the planâ??s IPS?*
- *Is the investment manager monitoring (and replacing, if needed) investment options consistent with the planâ??s IPS?*
- *Does the investment manager report performance compared to each strategyâ??s objective, appropriate benchmarks, and peer groups?*
- *Does the investment manager provide adequate rationale and documentation for investment changes made?*
- *Does the investment manager work with your provider to execute fund changes on your behalf?*

We also suggest that you periodically ask your investment manager questions about its organization, perhaps annually, to ensure the firm you hired has not changed in a way that could impact its ability to fulfill its duties.

Organizational Due Diligence

- *Have there been any changes to the management or ownership of the firm?*
- *Have there been any organizational changes to the firm that may impact plan management?*
- *Has there been a change to the firmâ??s status under the Investment Advisers Act of 1940?*
- *Has the firm been the subject of an investigation by any regulatory or government agency?*
- *Has the firm been routinely examined by regulators or independent auditors?*
- *Has the firm been the subject of any litigation (settled, pending, or threatened)?*
- *Have there been any material changes to the firmâ??s fidelity bond or errors and omissions insurance?*
- *Have there been any changes to the firmâ??s written fiduciary status related to the plan?*
- *Have there been any changes to the firmâ??s roles and responsibilities related to the plan?*
- *Has the firm disclosed all sources of compensation?*
- *Does the firm have any conflicts of interest with any of the planâ??s investment managers or other providers?*
- *What are the investment managerâ??s 3(38) assets under advisement?*
- *What is the total number of plans for which the investment manager acts as 3(38)?*

Putting a Bow on it

As Abbott pointed out above, â??a 3(38) arrangement is not a pass to abdicate all your investment fiduciary responsibilities.â?• Any move, whether it is across town or to a new fiduciary framework, requires a clear understanding of roles and responsibilities before making an informed decision.

Unless staffing trends reverse, the demands on human resources and finance departments lessen, or the complexity of managing retirement plans decreases, demand for defined contribution 3(38) investment manager services will continue to grow. If you are among the growing number of plan sponsors who finds the structure of a 3(38) arrangement optimal for your planâ??s management, establishing a framework for evaluation is an important step to fulfilling the new, though lessened, responsibilities introduced by this arrangement.

Legal Notice

This material is intended to be informational only and does not constitute legal, accounting, or tax advice. Please consult the appropriate legal, accounting, or tax advisor if you require such advice.

The opinions expressed in this report are subject to change without notice. This material has been prepared or is distributed solely for informational purposes. It may not apply to all investors or all situations and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. The information and statistics in this report are from sources believed to be reliable but are not guaranteed by CAPTRUST Financial Advisors to be accurate or complete. All publication rights reserved. None of the material in this publication may be reproduced in any form without the express written permission of CAPTRUST: 919.870.6822.

Â© 2026 CAPTRUST Financial Advisors