Regulating ERISA Fiduciary Outsourcing

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ABSTRACT: Pension and welfare benefit plans sponsored by private employers are big business. The sponsorship of these plans is the most heavily tax-subsidized private economic activity in the entire federal budget, with an estimated loss in federal tax revenues due to special tax breaks of over $1.485 trillion for the budget period 2014–2018. In exchange for these special tax breaks, the federal government heavily regulates private plans. To cope with the complexity, employers increasingly hire outside professional fiduciaries to run their employee benefit plans so that they can concentrate on running their businesses. Although this outsourcing of plan management and administrative functions is now widespread, minimal federal regulation governs these fiduciary outsourcing arrangements. As evidenced by a 2014 report issued by the Department of Labor's ERISA Advisory Council, both employers and the professional fiduciary-services industry want and need more guidance in the form of federal regulation. The need for regulation has become even more urgent in light of two subsequent developments: the Supreme Court's 2015 decision in Tibble v. Edison International*, which further encourages employers to outsource plan asset management functions; and the Employees Benefit Security Administration's promulgation of new regulations in 2016, which expand the universe of professional investment advisors who are ERISA fiduciaries. This Article explains and analyzes the unresolved issues that have emerged in this complex area of law, and proposes specific solutions to regulate fiduciary outsourcing arrangements more effectively.*

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I. Introduction

Imagine reporting for your first day of work at a new job. You sit down with the company's human resources manager to complete a two-inch-tall stack of paperwork. After 30 minutes, you reach the bottom of the stack, which consists of a packet labeled "Your Benefits." The human resources manager stands up and says, "Congratulations, you are now officially employed here. I'll show you to your office." Surprised, you respond, "But wait, aren't we going to go through my company benefits?" "No," responds the human resources manager, "the company takes no responsibility whatsoever for your retirement and healthcare benefits. You'll have to call the 800 number inside the packet and they will assist you."

The typical private employer[1] wants to operate a business, not an employee benefit plan.[2] But to attract and retain a competitive workforce, employers must offer competitive compensation packages, which include providing pension and welfare benefits (e.g., 401(k), profit sharing, retirement annuity benefits, health care, long-term care, life, and disability insurance) to their employees.[3] Given the complexities of compliance with the Employee Retirement Income Security Act of 1974 ("ERISA")[4]—the primary federal employment law that regulates employee benefit plans sponsored by private employers[5]—it is not surprising that employers have become increasingly interested in outsourcing the federal-fiduciary responsibilities associated with plan operation and administration.[6] Using outside professional fiduciaries to perform key plan functions can reduce

1. To simplify the presentation, the Article generally uses a single private employer who sponsors a single employer plan for its own employees as the governing paradigm for discussion purposes. *See* 29 U.S.C. § 1002(41) (2012) (defining single employer plan). Multiemployer plans and multiple employer plans, which become relevant when interpreting the statute as a whole, are discussed later in Part III.B.3 of the Article.

2. *See* ADVISORY COUNCIL ON EMP. WELFARE AND PENSION BENEFIT PLANS, OUTSOURCING EMPLOYEE BENEFIT PLAN SERVICES 5–6 (2014), https://www.dol.gov/sites/default/files/ebsa/about-ebsa/about-us/erisa-advisory-council/2014ACreport3.pdf [hereinafter ADVISORY COUNCIL REPORT].

3. According to the Bureau of Labor Statistics, total employer costs for employee compensation in private industry averaged 69.7% for wages and salaries, and 30.3% for employee benefits. *See* Press Release, Bureau of Labor Statistics, Employer Costs for Employee Compensation—June 2016 (Sept. 8, 2016), http://www.bls.gov/news.release/pdf/ecec.pdf.

4. Employee Retirement Income Security Act of 1974, Pub. L. No. 93–406, 88 Stat. 829 (codified as amended in scattered sections of 26 and 29 U.S.C.).

5. Other sources of federal regulation are the Internal Revenue Code ("IRC") requirements for tax-qualified pension plans that are not duplicated in parts 2 and 3 of Title I of ERISA, 29 U.S.C. §§ 1051–1058, 1081–1085, and the requirements of the Patient Protection and Affordable Care Act ("ACA") for employer-sponsored group health plans that are not already incorporated by reference in section 715 of ERISA, 29 U.S.C. § 1185(d). Neither the Code nor the ACA regulate the outsourcing of fiduciary responsibilities for the operation of employee benefit plans, which is solely regulated by part 4 of Title I of ERISA, 29 U.S.C. §§ 1101–1113.

6. *See* ADVISORY COUNCIL REPORT, *supra* note 2, at 5–6.

employer costs due to economies of scale and the use of advanced technology, and provide employers with access to specialized legal and administrative compliance expertise.[7]

As a result of employer demand, a sophisticated but largely unregulated private market has developed to provide professional investment and administrative fiduciary services for employee benefit plans.[8] In this private market, plan fiduciary functions are delegated under the statutory framework of sections 402[9] and 405[10] of ERISA, then customized to fit the particular needs of the employer through bargained service agreements between the employer and third-party professional fiduciaries.[11]

Employers' increasing use of outside professional fiduciaries presents both a challenge and an opportunity for the Employee Benefit Security Administration ("EBSA"), the division of the Department of Labor ("DOL") charged with interpreting and enforcing ERISA's fiduciary responsibility provisions. The challenge is that the statutory framework for outsourcing of plan fiduciary functions—enacted in and unchanged since 1974[12]—provides only minimal guidance. The opportunity lies in the ability of the EBSA to use its administrative agency powers to promulgate regulations that fill in these statutory gaps.

According to industry experts, ERISA's statutory provisions contain ambiguities that impede the efficient allocation of plan fiduciary functions and related pricing in bargained service agreements between employers and professional fiduciaries.[13] The most controversial example today involves

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7. *See id.*

8. *See id.* at 4–6. Although precise estimates of the revenues for the professional-fiduciary industry are not available, some figures regarding the significance of the dollars involved in private-employer pension and welfare benefit plans provide a sense of the magnitude of the professional services industry that assists employers. In terms of pension plans, the Investment Company Institute estimates that private-employer-sponsored defined-contribution and defined-benefit pension plans held $10 trillion in assets in 2014. *See* INV. CO. INST., 2015 INVESTMENT COMPANY FACT BOOK 137 (55th ed. 2015), https://www.ici.org/pdf/2015_factbook.pdf. For health-care plans, the federal Agency for Healthcare Research and Quality estimates that the total cost for enrollees in private-sector health-insurance plans in 2014 was over $600 billion. *See* AGENCY FOR HEALTHCARE RESEARCH & QUALITY, CTR. FOR FIN., ACCESS & COST TRENDS, 2014 MEDICAL EXPENDITURE PANEL SURVEY—INSURANCE COMPONENT (2014), http://meps.ahrq.gov/mepsweb/data_stats/summ_tables/insr/national/series_4/2014/tiva1.pdf.

9. 29 U.S.C. § 1102.

10. *Id.* § 1105.

11. *See* ADVISORY COUNCIL REPORT, *supra* note 2, at 6 ("The service provider contract is at the heart of all outsourcing arrangements. It is much more than just a legal document for allocating risk among the parties. The contract presents an opportunity to create a roadmap for the complex and customized relationships often involved in employee benefits outsourcing.").

12. *Compare* Employee Retirement Income Security Act of 1974, Pub. L. No. 93–406, 88 Stat. 829 §§ 402, 405 (1974), *with* 29 U.S.C. §§ 1102, 1105.

13. *See* ADVISORY COUNCIL REPORT, *supra* note 2, at 6 ("[T]here appears to be considerable confusion in the market over the precise extent to which plan sponsors have limited fiduciary risk through outsourcing arrangements. Combined with the lack of clear guidance on certain aspects

section 402(a) of ERISA, which requires that a named fiduciary must bear the overall responsibility for operating the plan.[14] Section 402(a) is unclear about whether an employer can outsource *all* of the fiduciary responsibilities associated with plan sponsorship by designating a third party to serve as the plan's named fiduciary, or whether there are some responsibilities that can never be delegated away.[15]

Professional fiduciaries are increasingly marketing a plan structure that delegates all fiduciary responsibilities—which I label "complete" outsourcing—to employers as the ultimate solution to the burden of federal fiduciary responsibilities associated with maintaining and operating an employee benefit plan.[16] As explained in detail later in Part II of this Article, ERISA imposes a wide-ranging set of obligations upon named plan fiduciaries and other delegated fiduciaries, including: (1) the duty to act prudently in operating the plan; (2) in selecting and monitoring plan investments, in hiring and retaining outside service providers to assist with plan administration; and (3) in paying only reasonable compensation using plan assets to outside plan service providers so as to protect and conserve the assets of the plan for the payment of benefits to plan participants.

In its November 2014 report to Secretary of Labor Thomas E. Perez, *Outsourcing Employee Benefit Plan Services*, the ERISA Advisory Council identified complete outsourcing as the "critical foundational issue" for the future of ERISA fiduciary outsourcing.[17] Complete outsourcing is

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of the legal framework for outsourcing . . . the marketplace could benefit from additional guidance from the Department [of Labor] in this area.").

14. *See* 29 U.S.C. § 1102(a).

15. *See* ADVISORY COUNCIL REPORT, *supra* note 2, at 10.

16. *See, e.g.*, *401K/403B*, PAYDAY HCM, http://paydayhcm.com/services/programs-products/retirement (last visited Oct. 18, 2016) ("Most 401K providers avoid fiduciary roles and won't take any of the fiduciary risk. We take a different approach; we appoint professional fiduciaries to all of our plans. These professionals will sign and act in . . . key fiduciary roles for you."); *A New Approach in the Delivery of Advisory Services to Retirement Plan Sponsors*, STONE HILL, http://stonehillfiduciary.com/new-approach (last visited Oct.18, 2016) ("Stone Hill Fiduciary Management enables plan sponsors and retirement plan committees to delegate fiduciary decision-making and reduce their involvement in plan administration and plan asset investment."); *Our Solution*, FIDUCIARY DOCTORS, http://www.fiduciarydoctors.com/our-solution (last visited Oct.18, 2016) ("Fiduciary Doctors is an independent, professional firm that takes your place as the named fiduciary and administrator for your company-sponsored retirement plans, removing the risk and liability of plan breaches from your shoulders and placing it on ours.").

17. ADVISORY COUNCIL REPORT, *supra* note 2, at 10. In my testimony before the Council, I explained that ERISA's statutory provisions do not require the plan's sponsoring employer to serve as the plan's named fiduciary, and that this premise—coupled with the application of the "nonfiduciary settlor function doctrine"—leads to the possibility of complete outsourcing. U.S. DEP'T OF LABOR, STATEMENT OF COLLEEN E. MEDILL BEFORE THE ERISA ADVISORY COUNCIL ON OUTSOURCING EMPLOYEE BENEFIT PLAN SERVICES (2014), http://www.dol.gov/ebsa/pdf/ACMedill061814.pdf; *see also* ADVISORY COUNCIL REPORT, *supra* note 2, at 10. This Article contains a comprehensive analysis of the issue of complete outsourcing in light of the Supreme Court's subsequent decisions in *Tibble v. Edison International*, 135 S. Ct. 1823 (2015), and *Fifth Third*

controversial because the emergence of professional "outside" named fiduciaries for employer-sponsored plans is a new market trend that divests the employer of responsibility under ERISA for the operation of the plan. Traditionally, employers who are not parties to a collective-bargaining agreement have served as the section 402(a) named fiduciaries for their own single-employer plans.[18] Some employers are attracted to complete outsourcing not only for the benefits of increased efficiency and expertise in plan administration, but also as a mechanism to avoid fiduciary liability under ERISA.

Complete outsourcing as an exculpatory technique is based on a Supreme Court-created exception to ERISA fiduciary duties, known as the settlor function doctrine.[19] This exception provides that an employer does not act as a fiduciary when it is establishing or amending the terms of an ERISA-regulated employee benefit plan.[20] In complete outsourcing situations, the employer either establishes a new plan that identifies a third party as the plan's named fiduciary, or amends an existing plan to designate a third party as the plan's named fiduciary.[21] In either case, the perceived benefit of designating a third party as the plan's named fiduciary is that the employer shifts *all* federal fiduciary responsibilities associated with the plan (and related liabilities for noncompliance) from itself to the outside professional fiduciary.[22] Because of the settlor function doctrine, the employer is not bound by a fiduciary duty to act in its employees' best interests when it designates the third party as the plan's named fiduciary via a plan amendment.

Employers' use of complete outsourcing as an exculpatory technique is likely to accelerate in the future as a result of the Supreme Court's 2015 decision in *Tibble v. Edison International*.[23] In *Tibble*, the Supreme Court held that an employer-fiduciary who sponsors an ERISA plan has an ongoing fiduciary duty to monitor the plan's menu of investment options and related mutual fund fees.[24] However, *Tibble* left unanswered a host of important practical questions—many of which predated it[25]—regarding the broader

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Bancorp v. Dudenhoeffer, 134 S. Ct. 2459 (2014). *See* discussion *infra* notes 235–45 and accompanying text; *see also* Part IV.A.

18. *See* discussion *infra* note 209. Employers who are parties to a collective-bargaining agreement contribute to a multiemployer plan for workers who are members of the bargaining unit. Multiemployer plans are sponsored by a board of trustees with equal representation of labor and management representatives. *See* discussion *infra* notes 171–75.

19. *See infra* Part II.C.

20. *See infra* Part II.C.

21. *See infra* Part III.B.2.

22. *See infra* Parts II.C, III.B.2.

23. Tibble v. Edison Int'l, 135 S. Ct. 1823 (2015).

24. *Id.* at 1828–29; *see also infra* Part IV.A.

25. *See* ADVISORY COUNCIL REPORT, *supra* note 2, at 14 ("[D]espite the importance of the concept of selection and monitoring of service providers, the Council heard a great deal of

implications of this duty to monitor. For example, how closely must the plan's named fiduciary monitor other co-fiduciaries?[26] It does not take a crystal ball to foresee that—when faced with a duty to monitor plan investments, coupled with the risk of millions of dollars in damages and attorneys' fees—employers who maintain ERISA plans are even more likely to consider using complete outsourcing as a way to circumvent their ERISA fiduciary responsibilities after *Tibble*.

The EBSA's promulgation of long-anticipated final regulations in April 2016 that define when an investment professional provides investment advice as an ERISA fiduciary amplifies the significance of *Tibble*.[27] Employers who sponsor pension plans often turn to outside investment professionals for assistance in making decisions about investing plan assets, or the menu of investment options in an individual account plan where the participants direct the investment of their own accounts. These new regulations greatly expand the universe of investment professionals who are ERISA fiduciaries.[28] Once these fiduciary regulations become final in January 2018, an employer (or, more likely, the members of the employer's plan investment committee) who uses a fiduciary investment advisor will be a co-fiduciary with the investment advisor, and will be exposed to joint and several liability for the investment advisor's breach of a fiduciary duty.[29] This regulatory change makes the need for additional EBSA guidance to address the circumstances when joint and several co-fiduciary liability arises more urgent.[30]

The EBSA's opportunity lies in its regulatory authority to interpret the statute.[31] As demonstrated in Part III of this Article, ERISA's statutory outsourcing provisions leave ample room for proactive regulation to guide and shape industry norms for "best practices" by employers and the professional fiduciary-services industry. Given the dollar amounts involved, there is a very strong federal interest in regulating the outsourcing of fiduciary services for employer-sponsored pension and welfare benefit plans. The magnitude of this federal interest in regulation can be measured (albeit indirectly) by the amount of the foregone tax revenues (in technical terms, the "tax expenditure") associated with the favorable tax treatment afforded employee benefit plans under the Internal Revenue Code ("IRC"). The estimated tax expenditure for the period 2014–2018 associated with employer-sponsored group health plans and long-term care insurance is

testimony suggesting that plan sponsors and other fiduciaries need additional guidance on how to meet those duties.").

26. *See* discussion *infra* notes 100–02.

27. *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20946, 20946 (April 8, 2016).

28. *See infra* notes 64–67 and accompanying text.

29. *See infra* notes 144–46 and accompanying text.

30. *See* discussion *infra* Parts III.A.2 & IV.B.4.

31. *See* Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842–44 (1984).

$785.1 billion.[32] For employer-sponsored pension plans, the total tax expenditure for this period is almost $700 billion.[33] These numbers represent the largest and second-largest tax expenditures in the entire federal budget.[34] With these incentives for employers to sponsor employee benefit plans and for employees to participate in them, there is a strong federal interest in regulating employer benefit plans to ensure that taxpayer dollars are being used in a way that is consistent with ERISA's underlying public policy objectives.[35]

This Article makes three interrelated claims regarding the need for more robust regulation of ERISA fiduciary outsourcing: (1) complete outsourcing as a purely exculpatory technique is ineffective to relieve entirely the plan's sponsoring employer from its federal fiduciary responsibilities under ERISA for the maintenance and operation of the plan; (2) *Tibble*'s unanswered questions make the need for regulatory guidance more urgent for litigation risk-adverse employers; and (3) the new EBSA regulations, which expand the universe of fiduciary investment advisors, increase the urgent need for further federal guidance regarding co-fiduciary responsibilities and related liabilities.

First, complete outsourcing as a means for employers to escape all federal fiduciary responsibilities under ERISA for the plans they sponsor is a fundamental misuse of the settlor function doctrine because it undermines the protective purposes of the statute.[36] The legislative history of ERISA, statutory syntax, and long-standing EBSA and lower federal court interpretations all indicate that complete outsourcing as an exculpatory technique should not be permitted.[37] This Article urges the EBSA to clarify that an employer's complete outsourcing of the section 402(a) named-fiduciary function *is* permissible for the purposes of achieving greater efficiency and gaining expertise in plan operation and administration, but that complete outsourcing cannot be used as a means for an employer to escape entirely its ERISA fiduciary responsibilities.[38]

Second, the Supreme Court's 2015 decision in *Tibble* adds urgency to the need for a timely regulatory rejection of complete outsourcing purely as an exculpatory technique.[39] Due to the increased risk of multimillion-dollar class-action lawsuits, *Tibble* makes complete outsourcing even more appealing to those employers who are wary of the unanswered questions regarding investment management raised by *Tibble*. Employers who are litigation risk-

32. *See* JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2014–2018, at 31 (2014).

33. *See id.* at 32.

34. *See id.* at 22–34.

35. *See* discussion *infra* notes 70–72 and accompanying text.

36. *See infra* Part III.B.5.

37. *See infra* Parts III.B.3–4.

38. *See infra* Part IV.B.1.

39. *See infra* Part IV.A.

averse are likely to turn to complete outsourcing in an attempt to eliminate entirely the federal fiduciary responsibilities associated with monitoring and managing the plan's investments.[40]

Third, the forthcoming implementation of EBSA's fiduciary investment advisor regulations in 2018 further amplifies the need for more instructive regulatory guidance concerning co-fiduciary duties and related joint and several liabilities under section 405(a) of ERISA.[41] Quite simply, once the fiduciary investment advisor regulations become fully effective in 2018, many more employers will become co-fiduciaries with their plan investment advisors. Significant ambiguities exist about the nature of co-fiduciary responsibilities under section 405(a), particularly with regard to the level of knowledge required to trigger a breach of a co-fiduciary duty under section 405(a)(1) and (3), and the scope of an employer's duty to monitor a co-fiduciary investment adviser under section 405(a)(2).[42]

Part II reviews the types of ERISA fiduciaries, ERISA fiduciary responsibilities, and the evolution of the settlor function doctrine. Part III discusses ERISA's statutory rules for outsourcing fiduciary functions, and analyzes the legal authority both for and against complete outsourcing. It claims that multiple sources of authority contradict the plain-language reading of the statute that proponents of complete outsourcing rely upon as a means for employers to avoid fiduciary responsibilities under ERISA, and urges the EBSA affirmatively to reject complete outsourcing as an exculpatory technique. It concludes that employers who engage in complete outsourcing may still achieve its benefits of greater efficiency and expertise in plan administration, but must retain the ultimate fiduciary responsibility for the selection and retention of section 402(a) named fiduciaries for their plans. Part IV examines the uncertainties that *Tibble* and the fiduciary duty to monitor plan investments and other co-fiduciaries create for employers. It concludes by identifying areas where additional administrative guidance is needed for employers, and by proposing specific regulatory techniques to provide that guidance.

Additional regulatory guidance would promote ERISA's primary policy objective of protecting the rights of plan participants and safeguarding their plan benefits.[43] It would also support ERISA's secondary cost-control policy objective[44] by bringing certainty to, and thereby strengthening the private market for, professional fiduciary services. In short, all of the interested stakeholders in the professional fiduciary services industry—the employers who sponsor ERISA plans, the employees who participate in those plans, and

40. *See* discussion *infra* notes 248–50 and accompanying text.
41. *See infra* Part IV.B.4.
42. *See infra* Part III.A.2.
43. *See infra* note 70 and accompanying text.
44. *See infra* note 71 and accompanying text.

the professional fiduciaries who service them—would benefit from regulatory action by the EBSA to address the areas of ambiguity identified in this Article.

II. ERISA FIDUCIARY RESPONSIBILITIES AND THE SETTLOR FUNCTION DOCTRINE EXCEPTION

A. *TYPES OF ERISA FIDUCIARIES*

ERISA recognizes no less than five types of fiduciaries, ranging from the most formal with the most expansive range of fiduciary responsibilities (a section 402(a) named fiduciary) to the least formal type of fiduciary with the least well-defined range of fiduciary responsibilities. The five types of ERISA fiduciaries are: (1) named plan fiduciaries under section 402(a)(1);[45] (2) plan administrators under section 3(16);[46] (3) plan trustees under section 403;[47] (4) plan investment managers under section 3(38);[48] and (5) functional fiduciaries under section 3(21)(A).[49]

1. Section 402(a)(1) Named Fiduciaries

Section 402(a)(1) of ERISA requires that every plan must have at least one named fiduciary, who is the person[50] designated in the plan document to have the overall authority to control and manage the operation and administration of the plan.[51] The purpose of the named fiduciary requirement is to inform the plan's participants exactly who is responsible for the overall administration and management of the plan and its assets.[52]

The plan document must either expressly identify a named fiduciary, or provide a specific procedure by which to identify one.[53] However, the plain language of section 402(a)(1) does not require an employment relationship between the named fiduciary for the plan and the plan's participants.[54] In the typical single-employer plan sponsored by an employer solely for its own (non-union) employees, the employer serves as the plan's named fiduciary.[55]

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45. Section 402(a)(2) defines a "named fiduciary" as a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary by an employer or employee organization with respect to the plan. *See* discussion *infra* text accompanying notes 165–66.

46. *See* 29 U.S.C. § 1002(16) (2012).

47. *See id.* § 1103.

48. *See id.* § 1002(38).

49. *See id.* § 1002(21)(A).

50. A "person" is defined broadly to include both individuals and various types of corporate entities. *See id.* § 1002(9).

51. *See* 29 C.F.R. § 2509.75–8 (2015) (citing to questions FR–13 and FR–14).

52. *See* H.R. REP. NO. 93-1280, at 297 (1974) (Conf. Rep.).

53. *See* 29 U.S.C. § 1102(a)(1)–(2).

54. *See id.* § 1102(a)(1).

55. *See infra* note 165 and accompanying text.

2. Section 3(16) Plan Administrators

In addition to a named fiduciary, every plan needs a section 3(16) plan administrator.[56] The plan administrator may, of course, perform other discretionary fiduciary functions that involve the management and operation of the plan.[57] If the plan does not designate a named fiduciary (who by default also would serve as the plan's administrator), then the employer who sponsors the plan becomes its section 3(16) administrator.[58] If the corporate-entity employer who sponsors the plan does not want to be liable for the fiduciary administrative responsibilities associated with the operation of the plan, the employer may designate an individual or a committee to serve as the section 3(16) plan administrator.[59] Alternatively, the employer may outsource the responsibilities of a section 3(16) administrator to a third-party professional plan administrator.[60]

3. Section 403(a) Trustees and Section 3(38) Plan Investment Managers

In addition to requiring a named fiduciary and a plan administrator, section 403 of ERISA requires that one or more trustees must hold the assets of the plan in trust.[61] The authority of the trustee with regard to the management of the plan's assets can be structured in different ways. A "discretionary" trustee may have full discretion to manage the plan's assets,[62] or a "directed" trustee may instead have only the authority to manage the plan's assets according to the directions of a named plan fiduciary or a section 3(38) investment manager.[63]

4. Section 3(21)(A) Functional Fiduciaries

The named fiduciary for the plan, the plan administrator, the trustee, and (perhaps) an investment manager are all "formal" fiduciaries with

56. Under part 1 of Title I of ERISA, it is the plan administrator who is formally charged with ensuring compliance with ERISA's reporting and disclosure requirements. *See* 29 U.S.C. §§ 1021–1025.

57. 29 U.S.C. § 1002(21)(A) (2012).

58. *Id.* § 1002(16)(A)(i)–(ii).

59. *Id.* § 1002(16); 29 C.F.R. § 2509.75–5 (2015) (citing to question FR–1); Colleen E. Medill, *The Federal Common Law of Vicarious Fiduciary Liability Under ERISA*, 44 U. MICH. J.L. REFORM 249, 274–75 (2011).

60. 29 U.S.C. § 1002(16); *see also id.* § 1002(9) (defining "person" without relation to the plan's sponsoring employer).

61. *Id.* § 1103(a); 29 C.F.R. § 2509.75.

62. 29 U.S.C. § 1103(a).

63. *See id.* § 1104(a). A section 3(38) "investment manager" is defined as "any fiduciary (other than a trustee or a named fiduciary) [under section 402(a)(2)]" who: (1) "has the power to manage, acquire, or dispose of any asset of a plan;" (2) is a registered investment advisor, a bank, or an insurance company authorized under federal or state law; and (3) "has acknowledged in writing that he is a fiduciary with respect to the plan." *Id.* § 1002(38).

identified titles and fiduciary functions specifically recognized by the statute. The fifth type of ERISA fiduciary is distinctly different. Section 3(21)(A) of ERISA recognizes as a fiduciary any person who performs certain functions with respect to a plan, but only to the extent that she performs such functions (and not for all purposes, as with a named fiduciary).[64] Under section 3(21)(A), it is the conduct of a person with respect to the plan that triggers fiduciary status, irrespective of whether that person has been formally designated as a fiduciary or even knows that she is a plan fiduciary.[65] Section 3(21) fiduciaries include any person who has any discretionary authority or control over the administration or management of the plan, or has any control (whether discretionary or not) over the plan's assets.[66] Section 3(21)(A) fiduciaries also include any person who renders "investment advice" regarding the assets of the plan for a direct or indirect fee or other compensation.[67] In addition, the Supreme Court has held that any person with apparent authority who communicates with plan participants about their benefits can be a section 3(21)(A) plan fiduciary.[68]

B. *ERISA Fiduciary Responsibilities*

All ERISA fiduciaries are subject to the fiduciary responsibility provisions set forth in part 4 of Title I of ERISA.[69] These provisions reflect two often-competing underlying policy objectives. ERISA's primary policy objective is to protect the rights of plan participants and their promised plan benefits, (the protective policy).[70] ERISA's secondary policy objective is to avoid discouraging employers from voluntarily sponsoring benefit plans for their workers by minimizing the administrative burdens and related costs

64. *See id.* § 1002(21)(A).

65. *See id.; see also* Freund v. Marshall & Ilsley Bank, 485 F. Supp. 629, 635 (W.D. Wis. 1979) ("It is apparent from the evidence that many of these persons were confused about the nature of their fiduciary duties and indeed unsure whether they were fiduciaries with respect to the Plan. . . . Their state of mind, however, does not determine their fiduciary status under ERISA.").

66. *See* 29 U.S.C. § 1002(21)(A)(i), (iii).

67. *See id.* § 1002(21)(A)(ii). The EBSA twice proposed new regulations attempting to define more precisely who is a fiduciary for purposes of rendering retirement investment advice. *See generally* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21928 (Apr. 20, 2015) (withdrawing a previously proposed rule and issuing a new proposed rule). A final rule was issued on April 8, 2016. *See generally* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20946. Although a detailed discussion of fiduciary status under the final rule is beyond the scope of this Article, the consensus is that the new interpretation will greatly expand the ranks of persons who act as fiduciary investment advisors.

68. *See* Varity Corp. v. Howe, 516 U.S. 489, 506–07 (1996).

69. *See* 29 U.S.C. §§ 1101–1113(2012).

70. *See Varity Corp.*, 516 U.S. at 496–97; Mertens v. Hewitt Assocs., 508 U.S. 248, 262–63 (1993).

associated with plan sponsorship (the cost-control policy).[71] In crafting ERISA, Congress attempted to strike a balance between these two policy goals.[72] From a policy perspective, outsourcing fiduciary functions associated with the operation and administration of the plan has the potential to promote *both* of ERISA's objectives. If expert professional fiduciaries are able to execute the specialized fiduciary functions necessary for the administration of the plan and the management of plan assets with a higher degree of competence and at a lower cost than the employer who sponsors the plan, then both the plan participants and the plan's sponsoring employer are better off. In today's legal environment, however, a lack of regulatory guidance impedes competition and competitive pricing in the market for professional fiduciary services.[73] The ERISA Advisory Council succinctly described the problem as follows:

> [T]here appears to be considerable confusion in the market over the precise extent to which plan sponsors have limited fiduciary risk through outsourcing arrangements. Combined with the lack of clear guidance on certain aspects of the legal framework for outsourcing . . . the marketplace could benefit from additional guidance from the Department [of Labor] in this area.[74]

Although the standard argument against more regulation is that it will increase compliance costs, in the area of ERISA fiduciary outsourcing, industry experts believe that additional federal regulation has the potential to *reduce* compliance costs. By standardizing industry norms for fiduciary services and the terms of related service agreements with employers, increased regulation can introduce greater price competition into the market place by facilitating the ability of employers to engage in price comparisons among fiduciary service providers.

Understanding why the professionals in the fiduciary services industry actually desire more regulatory guidance requires a foundational knowledge of ERISA's statutory provisions that govern fiduciary conduct, along with the context in which Congress enacted these provisions in 1974.[75] When

71. *See Mertens*, 508 U.S. at 262–63 (quoting Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504, 515 (1981)); Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 148 n.17 (1985).

72. *See* H.R. REP. NO. 93-533, at 1 (1973) ("The primary purpose of the bill is the protection of individual pension rights, but the committee has been constrained to recognize the voluntary nature of private retirement plans. The relative improvements required by this Act have been weighed against the additional burdens to be placed on the system. While modest cost increases are to be anticipated when the Act becomes effective, the adverse impact of these increases have been minimized.").

73. *See* ADVISORY COUNCIL REPORT, *supra* note 2, at 5–6.

74. *Id.* at 6.

75. For a review of the legislative history of ERISA, see S. REP. NO. 93-127, at 3–7 (1973); H.R. REP. NO. 93-533, at 2–5, 7–9 (1973); Michael S. Gordon, *Introduction to the First Edition: The Social Policy Origins of ERISA*, *in* EMPLOYEE BENEFITS LAW xcix–cxviii (Jeffrey Lewis et al.

Congress enacted ERISA in 1974, it was reacting to well-publicized instances of corruption in plan asset management.[76] Congress used the paradigm of the common law of trusts to address the problem.[77] Consequently, the starting point for ERISA fiduciary standards became the requirement that "all assets of an employee benefit plan shall be held in trust by one or more trustees."[78] Building on the trust-law paradigm, section 404(a)(1) of ERISA[79] establishes various fundamental duties (all derived from the common law of trusts) that govern the conduct of ERISA fiduciaries. These fundamental fiduciary duties are: (1) a duty of loyalty; (2) a duty of prudence; (3) a duty of prudent diversification; and (4) a duty to discharge duties in accordance with documents governing the plan, so long as those documents are consistent with Titles I and IV of ERISA.

1. Duties of Loyalty, Prudence and Diversification

Under section 404(a)(1)(A)(i), a fiduciary generally must discharge all of his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries.[80] This duty is commonly referred to as the "duty of loyalty,"[81] or the "exclusive benefit rule."[82]

Section 404(a)(1)(B) requires the fiduciary to discharge his duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with

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eds., 3d ed. 2012); Michael Gordon, *Overview: Why Was ERISA Enacted?*, *in* THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: THE FIRST DECADE 1–25 (1984).

76. For discussion of the corruption in the management of plan assets that led to the enactment of ERISA, see *Russell*, 473 U.S. at 140 n.8; *Private Welfare and Pension Plan Legislation: Hearings on H.R. 1045, H.R. 1046, and H.R. 16462 Before the Gen. Subcomm. on Labor of the H. Comm. on Educ. and Labor*, 91st Cong. 470–72 (1970) (testimony of George P. Shultz, Secretary of Labor); 120 CONG. REC. 4279–80 (1974) (statement of Rep. Brademas); 120 CONG. REC. 4277–78 (1974) (statement of Rep. Perkins); and 119 CONG. REC. 30,003–06 (1973) (statement of Sen. Williams). *See generally* PRESIDENT'S COMM. ON CORP. PENSION FUNDS & OTHER PRIVATE RET. AND WELFARE PROGRAMS, PUBLIC POLICY AND PRIVATE PENSION PROGRAMS (1965); R.C. James, *Manipulation of a Joint Pension Board for Power Purposes: The Teamsters Experience*, 20 N.Y.U. CONF. ON LABOR 381 (1968); F.M. Kleiler, *The Law, The Pension Fund, and the Trustee*, 20 N.Y.U. CONF. ON LABOR 395 (1968).

77. *See* Varity Corp. v. Howe, 516 U.S. 489, 496–97 (1996); Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 110–11 (1989); H.R. REP. NO. 93-1280, at 298–301 (1974) (Conf. Rep.); H.R. REP. No. 93-533, at 11–13 (1973); S. REP. NO. 93-127, at 28–29, 33–34 (1973); *see also* Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1107–08 (1988).

78. 29 U.S.C. § 1103(a) (2012); *see also* Fischel & Langbein, *supra* note 77, at 1107 (describing section 403 as a rule of mandatory trusteeship). ERISA section 403(b) lists various limited exceptions to the norm that plan assets must be held in a trust. *See* 29 U.S.C. § 1103(b).

79. 29 U.S.C. § 1104(a).

80. *Id.* § 1104(a)(1)(A)(i).

81. *Varity Corp.*, 516 U.S. at 506.

82. *See* Fischel & Langbein, *supra* note 77, at 1108–10.

like aims."[83] This duty is known as the prudent expert rule or the duty of prudence.[84]

Section 404(a)(1)(C), known as the "duty of prudent diversification," requires the responsible fiduciary to "diversify[] the investments of the plan" prudently under the circumstances "so as to minimize the risk of large losses, unless under the circumstances it is clearly [im]prudent . . . to do so."[85] Given that most employers are neither experts in investment management or, more generally, in plan administration, these section 404 fiduciary duties create an incentive for employers to seek the help of outside professional fiduciaries to carry out their fiduciary responsibilities.[86]

2. Duty to Follow Plan Document Terms

Although Congress intended ERISA to codify the principles of fiduciary conduct developed under the common law of trusts, lawmakers also recognized that certain modifications would be necessary for operating modern employee benefit plans.[87] The fourth fundamental ERISA fiduciary duty, contained in section 404(a)(1)(D),[88] is unique to federal fiduciary law. Section 404(a)(1)(D) requires a fiduciary to "discharge his duties . . . in accordance with the documents . . . governing the plan[, but only] insofar as [those] documents . . . are consistent with the [other statutory provisions of Titles I and IV of ERISA]."[89] Section 404(a)(1)(D) prevents employer abuse in designing the terms of the plan. Although the employer acts as a settlor and not as a fiduciary when it designs those terms, it does act as a fiduciary

83. 29 U.S.C. § 1104(a)(1)(B).

84. *See, e.g.*, Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983) (discussing the prudent man rule as a "flexible standard"); Donovan v. Mazzola, 716 F.2d 1226, 1231 (9th Cir. 1983) (stating that the district court properly "applied the prudent person test").

85. 29 U.S.C. § 1104(a)(1)(C) (2012); *see also* Brock v. Citizens Bank of Clovis, 841 F.2d 344, 346 (10th Cir. 1988); Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan, 507 F. Supp. 378, 383 (D. Haw. 1980). The duty of prudent diversification is designed to prevent the fiduciary from concentrating the investment of the plan's assets in a single type of investment, geographic location, or industry. *See* H.R. REP. NO. 93-1280, at 304 (1974) (Conf. Rep.). Significantly, ERISA exempts individual account plans, such as 401(k) plans, from this duty of prudent diversification with respect to the acquisition or holding of company stock that constitutes qualifying employer securities. *See* 29 U.S.C. §§ 1104(a)(2), 1107(d)(5).

86. *See* ADVISORY COUNCIL REPORT, *supra* note 2, at 1.

87. *See* Varity Corp. v. Howe, 516 U.S. 489, 496–97 (1996); Leigh v. Engle, 727 F.2d 113, 123 n.19 (7th Cir. 1984); *Cunningham*, 716 F.2d at 1464; H.R. REP. NO. 93-533, at 3–5, 11–13 (1973); H.R. REP. NO. 93-1280, at 302 (1974) (Conf. Rep.).

88. 29 U.S.C. § 1104(a)(1)(D).

89. *Id.* § 1104(a)(1). In contrast, under the common law of trusts the settlor of the trust could alter the trustee's default fiduciary duties of loyalty, prudence, and trust-asset diversification through the terms of the trust instrument. Section 404(a)(1)(D) makes ERISA's statutory fiduciary standards mandatory. *See* John H. Langbein, *Trust Law as Regulatory Law: The Unum/Provident Scandal and Judicial Review of Benefit Denials Under ERISA*, 101 NW. U. L. REV. 1315, 1336–40 (2007).

when it administers them.[90] Section 404(a)(1)(D) provides an important check on potential employer overreaching by requiring that the fiduciaries of the plan must disregard any terms of the plan that would be contrary to ERISA's statutory provisions.

3. Other Statutory Modifications to Trust Law

Three more ERISA statutory modifications to the common law of trusts are relevant in the context of fiduciary outsourcing: (1) preventing the trustee from avoiding liability with an exculpatory clause; (2) prohibiting fiduciary indemnification; and (3) expanding the scope of possible fiduciaries.

4. Fiduciary Exculpatory Clauses

One key statutory modification that promotes ERISA's protective policy is section 1110(a).[91] Section 1110(a) eliminates the common law practice of relieving the trustee from liability for breach of trust by including an exculpatory clause in the trust agreement.[92] Under section 1110(a), "any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under . . . part [4 of Title I of ERISA] shall be void as against public policy."[93]

5. Fiduciary Indemnification Using Plan Assets

The EBSA interprets section 1110(a) as further prohibiting any fiduciary indemnification (including an outside professional fiduciary) using plan assets because "[s]uch an arrangement would have the same result as an exculpatory clause, in that it would, in effect, relieve the fiduciary of responsibility and liability to the plan by abrogating the plan's right to recovery from the fiduciary for breaches of fiduciary obligations."[94] This prohibition means that when an employer negotiates an indemnification clause in a fiduciary service agreement with an outside professional fiduciary,

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90. *See* 29 U.S.C. § 1002(21)(A) (2012); Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 444–45 (1999); Lockheed Corp. v. Spink, 517 U.S. 882, 890 (1996).

91. *See* 29 U.S.C. § 1110(a).

92. *Compare id.*, *with* RESTATEMENT (SECOND) OF TRUSTS § 222(1) (1959). Under the common law of trusts, an exculpatory clause was effective to relieve the trustee for liability for breach of trust only to the extent that the trustee did not act in bad faith, intentionally, or with reckless indifference. *See id.* § 222(2).

93. 29 U.S.C. § 1110(a).

94. 29 C.F.R. § 2509.75–4 (2015). Although plan assets may not indemnify a fiduciary, the plan may purchase fiduciary-liability insurance for a fiduciary so long as the policy permits recourse by the insurer against the fiduciary if a breach of fiduciary duty is proven. *See* 29 U.S.C. § 1110(b)(1). This restriction—that the insurer must have a right of recourse against the fiduciary under the terms of the fiduciary-liability policy—does not apply if the fiduciary personally purchases the insurance, or the employer who sponsors the plan purchases the insurance for the fiduciary. *See* 29 U.S.C. § 1110(b)(2)–(3). As a practical matter, the corporate employer typically purchases fiduciary-liability insurance coverage for its internal officers and employees who serve as plan fiduciaries.

it is the employer's assets that must be used to indemnify the professional fiduciary. Importantly, ERISA's bonding requirement for plan fiduciaries who handle plan assets only provides protection against losses due to theft, not losses due to breaching fiduciary responsibilities.[95] This means that plan participants who suffer a loss caused by a fiduciary's breach of duty must look to the fiduciary's own assets for monetary relief.

6. Expanded Universe of Fiduciaries

The final relevant statutory modification to the common law of trusts relates to ERISA's expanded scope of possible fiduciaries.[96] Under the common law of trusts, only the trustee served as a fiduciary.[97] In contrast, under ERISA an employee benefit plan may (and often does) have multiple fiduciaries.[98]

This modification has important ramifications for outsourcing of plan fiduciary functions. First, any person—whether or not a named fiduciary of the plan—who has the power to appoint or retain a person who will perform fiduciary functions with respect to the plan acts as a fiduciary when exercising these appointment and retention powers.[99] Moreover, as part of a fiduciary's general duty of prudence, an appointing fiduciary has an ongoing fiduciary duty periodically to review the appointed fiduciary's performance for compliance with the terms of the plan and with ERISA's fiduciary standards.[100] This ongoing fiduciary responsibility is known as the "duty to monitor."[101] The duty to monitor further requires that the appointing fiduciary must exercise due care when delegating fiduciary tasks to other fiduciaries, including outside professional fiduciaries.[102]

The common law of trusts placed the risk of misappropriating or mismanaging trust assets onto the trustee. ERISA shifts that risk allocation by allowing multiple fiduciaries to administer the plan and to manage and invest the plan's assets. In moving from a one-dimensional trustee model to a multi-dimensional fiduciary model, Congress did not attempt to anticipate and address all of the potential complications that could arise from this paradigm

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95. *See* 29 U.S.C. § 1112(a) (2012).

96. *See supra* Part II.A.

97. *See* Fischel & Langbein, *supra* note 77, at 1105–19 (comparing trust law with ERISA fiduciary law).

98. *See supra* Part II.A.

99. *See* 29 C.F.R. § 2509.75–8 (citing to question D–4); *see also* Coyne & Delany Co. v. Selman, 98 F.3d 1457, 1465 (4th Cir. 1996); Kling v. Fid. Mgmt. Tr. Co., 323 F. Supp. 2d 132, 142 (D. Mass. 2004).

100. *See* 29 U.S.C. § 1108(g)(10)(B) (2012).

101. *See, e.g.*, *Selman*, 98 F.3d at 1465–66; Martin v. Feilen, 965 F.2d 660, 669–670 (8th Cir. 1992); Leigh v. Engle, 727 F.2d 113, 134–35 (7th Cir. 1984); *Kling*, 323 F. Supp. 2d at 142; *In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 553, 553 n.59 (S.D. Tex. 2003); *see also* 29 C.F.R. § 2509.75–8 (citing to question FR–17).

102. *See* 29 C.F.R. § 2509.75–8.

shift.[103] In fairness, there was no common-law analogue to today's complex world of employee benefit plans. In enacting ERISA, Congress opted for a general framework of principles for delegating and allocating fiduciary functions (collectively, "ERISA's outsourcing rules"), which are found in sections 402 and 405 of ERISA.[104] Before turning to a closer examination of ERISA's outsourcing rules in Part III, however, it is important first to understand the Supreme Court's judicially-created exception to Congress's statutory scheme for regulating plan fiduciaries.

C. *The Settlor Function Doctrine*

The judicial principle that establishing or amending the terms of an ERISA plan is a nonfiduciary "settlor" function by the employer and not a fiduciary act (the "settlor function doctrine") is an important exception to ERISA's fiduciary responsibility provisions.[105] Accordingly, the corporate employer who sponsors the plan does not have a fiduciary duty to act exclusively in the interests of the plan's participants when it establishes or amends the plan's terms.[106]

The settlor function doctrine has evolved over time in a trilogy of Supreme Court decisions. The Court first articulated the doctrine in *Curtiss–Wright v. Schoonejongen*, where an employer amended its retiree health care plan so that its coverage would cease for retirees and their dependents if the facility from which they retired terminated business operations.[107] Shortly after the amendment, the employer closed a facility and terminated health care benefits for retirees from those facilities.[108] In addressing a claim by the affected retirees that the employer acted improperly in terminating the retirees' benefits, the Court stated that "[e]mployers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate welfare plans."[109]

Lockheed Corporation v. Spink further elaborated on the reasoning behind the settlor function doctrine and extended the doctrine to pension plans.[110] In *Spink*, the company's board of directors amended a defined benefit pension plan to provide additional benefits for certain employees who accepted an early retirement offer, but conditioned the employee's eligibility

103. *See* Fischel & Langbein, *supra* note 77, at 1126–27 (criticizing ERISA's trust law-based exclusive benefit/duty of loyalty rule as inconsistent with the use of internal officers and employers in modern plan administration).

104. 29 U.S.C. §§ 1102, 1105.

105. *See* Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 444–45 (1999); Lockheed Corp. v. Spink, 517 U.S. 882, 890 (1996); Curtiss–Wright Corp. v. Schoonejongen, 514 U.S. 73, 78 (1995).

106. *See Hughes Aircraft Co.*, 525 U.S. at 444; *Spink*, 517 U.S. at 892.

107. *Curtiss–Wright Corp.*, 514 U.S. at 75.

108. *Id.* at 76.

109. *Id.* at 78.

110. *Spink*, 517 U.S. at 890–91.

for the early retirement program on his execution of a release of all employment-related claims against the company.[111] Paul Spink was eligible for the enhanced early retirement benefits, but did not want to waive his possible age discrimination claims against the company.[112] He retired early without earning the additional benefits because he refused to execute the required release.[113] Spink then sued the company and its board of directors, alleging that they acted as fiduciaries by amending the terms of the pension plan to create the early retirement incentive program, and that this action violated ERISA's fiduciary responsibility provisions.[114] The *Spink* Court held as follows:

> We first address the allegation in Spink's complaint that Lockheed and the board of directors breached their fiduciary duties when they adopted the amendments establishing the early retirement programs. Plan sponsors who alter the terms of a plan do not fall into the category of fiduciaries. As we said with respect to the amendment of welfare benefit plans in *Curtiss–Wright Corp. v. Schoonejongen*, "[e]mployers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate welfare plans." When employers undertake those actions, they do not act as fiduciaries, but are analogous to the settlors of a trust.
>
> This rule is rooted in the text of ERISA's definition of fiduciary. As the Second Circuit has observed, "only when fulfilling certain defined functions, including the exercise of discretionary authority or control over plan management or administration," does a person become a fiduciary under § 3(21)(A). "[B]ecause [the] defined functions [in the definition of fiduciary] do not include plan design, an employer may decide to amend an employee benefit plan without being subject to fiduciary review. . . ."
>
> We see no reason why the rule of *Curtiss–Wright* should not be extended to pension benefit plans. . . .
>
> Lockheed acted not as a fiduciary but as a settlor when it amended the terms of the Plan to include the retirement programs.[115]

In this passage from *Spink*, the Supreme Court rooted the settlor function doctrine solely in the catch-all definition of a fiduciary under section

111. *Id.* at 885.

112. *Id.* at 885–86.

113. *Id.* at 886.

114. *Id.* at 885–86. Specifically, Spink claimed that the amendment was a violation of ERISA's prohibited transaction rules. *See id.* at 886–89.

115. *Id.* at 889–91 (alterations in original) (citations omitted) (quoting Curtiss–Wright Corp. v. Schoonejongen, 514 U.S. 73, 78 (1995)); Siskind v. Sperry Ret. Program, Unisys, 47 F.3d 498, 505 (2d Cir. 1995)).

3(21)(A).[116] In addition, the Court emphasized that the plan amendment at issue did not implicate the core fiduciary functions of discretionary plan management and administration.[117]

The third case in the Supreme Court's settlor function trilogy, *Hughes Aircraft Co. v. Jacobson*, involved an amendment to a pension plan that both created an early retirement incentive and reduced the benefits available to new participants in the plan by eliminating an employer contribution feature.[118] Participants in the plan sued the company, alleging multiple violations of ERISA's fiduciary responsibility provisions.[119] The Supreme Court held that "[e]ach of respondents' fiduciary duty claims must fail because ERISA's fiduciary provisions are inapplicable to the amendments. This conclusion follows from our decision in *Spink*."[120] In elaborating on this holding, the *Hughes Aircraft* Court again emphasized that the plan amendment at issue did not implicate the core functions of discretionary plan management and administration:

> In general, an employer's decision to amend a pension plan concerns the composition or design of the plan itself and does not implicate the employer's fiduciary duties which consist of such actions as the administration of the plan's assets. ERISA's fiduciary duty requirement simply is not implicated where Hughes, acting as the Plan's settlor, makes a decision regarding the form or structure of the Plan such as who is entitled to receive Plan benefits and in what amounts, or how such benefits are calculated.[121]

In the most comprehensive law review article on the settlor function doctrine to date, Professors Dana Muir and Norman Stein criticize the Supreme Court's framing of the settlor function doctrine in this trilogy of cases as a mechanical test.[122] Muir and Stein present numerous examples of how the application of the settlor function doctrine results in outcomes that are inconsistent with ERISA's primary policy objective of protecting plan participants and their promised plan benefits.[123] One example is a plan amendment that dictates a 401(k) plan's menu of investment options for plan

116. *See id.* at 890.

117. *See id.* See *infra* notes 231–38 and accompanying text for the argument that the settlor-function doctrine should not be misused so as to immunize an employer who selects a third party as the plan's section 402(a) named fiduciary from ERISA's fiduciary responsibility standards in selecting or retaining the named fiduciary.

118. Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 436 (1999).

119. *Id.* at 436–37. One of the alleged violations involved a claim of breach of fiduciary duties and prohibited transactions under ERISA section 406. *See id.* at 437.

120. *Id.* at 443.

121. *Id.* at 444 (citations omitted).

122. Dana Muir & Norman Stein, *Two Hats, One Head, No Heart: The Anatomy of the ERISA Settlor/Fiduciary Distinction*, 93 N.C. L. REV. 459, 460 (2015).

123. *See id.* at 493–514.

participants. Contrary to the settlor function doctrine, the EBSA takes the position that the selection of 401(k) plan investment options is a fiduciary function.[124] Focusing on how the judiciary might address this particular example, Muir and Stein reference in passing the complete outsourcing exculpatory technique. Muir and Stein conclude that the federal courts could:

> [A]cknowledge that some plan design decisions are, in fact, fiduciary decisions, pulling back from the rhetoric in *Spink*. As we have already noted, *Spink* held that plan amendments (and that presumably extends to plan design decisions in the initial plan document) are never plan administrative or management decisions and thus not fiduciary activities. But the decision conflates administrative and management decisions, which are referred to in separate clauses of the statutory definition of fiduciary and were almost certainly intended by Congress to have different meanings.
>
> The authors conclude that the idea that plan amendments are not fiduciary in nature because they do not fit within the statutory definition of fiduciary administrative decisions does not necessarily mean that the amendments can never constitute fiduciary plan management decisions. Early in the last subsection, we described how collateral limitation could support the [EBSA]'s position that the selection of plan investments is always a fiduciary function—regardless of whether the investment options are included in the plan's terms. Acknowledgement that there is a difference between administrative and management decisions involving the plan could support the [EBSA]'s view that both investment selection and monitoring are always fiduciary decisions. At one level, we believe that the [EBSA]'s position seems inconsistent with the Supreme Court's holding in *Hughes* that the act of plan amendment is always a settlor function. *But the identification of a person as a named fiduciary in a plan document* or the selection of an investment menu for a participant defined contribution plan are arguably plan management decisions, even if implemented through a plan amendment. . . .

124. *Id.* at 499 (quoting Final Regulation Regarding Participant Directed Individual Account Plans (ERISA Section 404(c) Plans), 57 Fed. Reg. 46,906, 46,924 n.27 (Oct. 13, 1992) (codified at 29 C.F.R. § 2550.404c–1 (2015))); *see also* 29 C.F.R. § 2550.404c-5(b)(2) ("Nothing in this [regulation] shall relieve a fiduciary from his or her duties under . . . ERISA to prudently select and monitor any qualified default investment alternative under the plan or from any liability that results from a failure to satisfy these duties, including liability for any resulting losses."); Colleen E. Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality*, 49 EMORY L.J. 1, 38 (2000) ("The employer must prudently select and monitor the ongoing appropriateness of the plan's menu of investment options. . . .").

> There is, then, a basis for pulling back from the broad statement in *Spink*, which was not necessary to the *Spink* decision and might be considered dicta rather than the case's holding.[125]

Ultimately, Muir and Stein conclude that the last best hope for reforming the settlor function doctrine lies with either the judiciary or with Congress.[126] Muir and Stein developed their article in a very fluid judicial environment,[127] and published it prior to the Supreme Court's decision in *Tibble v. Edison International*.[128] This Article suggests a different approach to reform, namely that immediate regulatory action by the EBSA is both possible and necessary to prevent the expansion of the settlor function doctrine to include complete outsourcing as a nonfiduciary action by the employer who sponsors the plan.

III. OUTSOURCING FIDUCIARY FUNCTIONS

Recall that the role of the section 402(a) named fiduciary is unique in that the plan's named fiduciary is liable for the entire operation and administration of the plan.[129] For a named fiduciary to curtail this unlimited fiduciary liability by allocating various fiduciary functions to other persons, the plan document must be written according to ERISA's outsourcing rules. These rules require that the plan document must set forth a procedure whereby the plan's named fiduciary allocates or delegates fiduciary responsibilities to other co-fiduciaries.[130] If a named fiduciary utilizes such a procedure to outsource various fiduciary functions, the named fiduciary does not escape fiduciary liability for the outsourced fiduciary functions entirely. Rather, the scope of the named fiduciary's liability for the outsourced fiduciary function changes from unlimited strict liability to a more narrow brand of fault-based, joint and several co-fiduciary liability.[131]

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125. Muir & Stein, *supra* note 122, at 545–46 (emphasis added) (footnotes omitted).

126. *Id.* at 549 ("We have suggested ways that the Supreme Court might retreat a bit from the doctrine, but we also recognize that rote judicial adherence to the doctrine over time has made retreat more difficult. Perhaps we will have to rely on Congress to legislate limits on the doctrine. But perhaps more judicial focus on and discussion of contexts broader than particular cases is yet possible. Indeed, we wrote this Article to help stimulate such a discussion, for hope springs eternal, even among those of us who write and think about ERISA.").

127. *Id.* ("We have shown in this Article instances where the settlor/fiduciary doctrine has produced troubling outcomes and have predicted that the broad berth the courts have given the doctrine, if left unchecked, will lead to even more disturbing outcomes in the future. Indeed, in the course of working on this Article, we twice had to move a discussion of predicted outcomes to a discussion of settled Supreme Court jurisprudence.").

128. *See infra* Part IV.A.

129. *See supra* notes 50–52 and accompanying text.

130. *See infra* note 136 and accompanying text.

131. *See* 29 U.S.C. § 1105(a), (c)(2) (2012); 29 C.F.R. § 2509.75–8 (2015) (citing to questions FR–13 and FR–14).

A. *ERISA'S OUTSOURCING RULES*[132]

Sections 402 and 405(c) of ERISA set forth, in a bare-bones fashion, the procedures for the outsourcing of fiduciary functions using the terms of the plan document. In addition, section 405(a) of ERISA imposes co-fiduciary duties upon the fiduciary who outsources fiduciary functions to a co-fiduciary party.

1. Outsourcing Fiduciary Functions Under Sections 402 and 405

"Sections 402 and 405 of ERISA form the 'barebones' statutory framework [for] fiduciary outsourcing arrangements" between a section 402(a) named fiduciary and outside professional fiduciaries.[133] Section 402 requires that every plan must be established and maintained pursuant to a written instrument, and further describes the mandatory and optional written provisions concerning plan administration that are to be written in the plan.[134] Plan provisions that allocate or delegate fiduciary responsibilities are an optional plan-design provision.[135] Importantly, section 402(b)(2) states that any procedure for allocating or delegating fiduciary responsibilities for administering the plan must be specified in the plan document itself, "including any procedure[s] described in section [405(c)(1)]," discussed in detail below.[136] Section 402(c) authorizes two additional optional plan document provisions that are highly relevant to fiduciary outsourcing activities. First, section 402(c)(2) permits the plan to authorize the named fiduciary (or a designee) to employ persons to render advice regarding fiduciary responsibilities.[137] Second, section 402(c)(3) permits the plan to authorize the named fiduciary to appoint a section 3(38) investment manager to acquire and dispose of plan assets.[138]

Section 405 picks up where section 402(b)(2) stops. Section 405(c)(1), incorporated by reference in section 402(b)(2), elaborates on how a plan's named fiduciary can allocate or delegate fiduciary responsibilities for administering or managing the plan. Section 405(c)(1) provides that: "The instrument under which a plan is maintained may expressly provide for

132. Portions of Part III are based on the author's prior written testimony before the ERISA Advisory Council. *See* U.S. DEP'T OF LABOR, *supra* note 17.

133. *See id.*

134. The Supreme Court considers functions that fall within the mandatory or optional plan provisions described in section 402 to be core administrative functions that are not subject to potentially conflicting state laws or regulations, which guarantees uniformity for plans that are administered in multiple jurisdictions. *See* Kennedy *ex rel.* Estate of Kennedy v. Plan Adm'r for DuPont Sav. & Inv. Plan, 555 U.S. 285, 303 (2009); Egelhoff v. Egelhoff *ex rel.* Breiner, 532 U.S. 141, 150 (2001).

135. *See* 29 U.S.C. § 1102(c)(2)–(3).

136. *Id.* § 1102(b)(2).

137. *Id.* § 1102(c)(2).

138. *Id.* § 1102(c)(3).

procedures (A) for allocating fiduciary responsibilities (other than trustee responsibilities) among named fiduciaries, and (B) for named fiduciaries to designate persons other than named fiduciaries to carry out fiduciary responsibilities (other than trustee responsibilities) under the plan."[139]

For the purposes of subsequent discussion, I call this plan a "405(c) fiduciary services agreement" because the terms of the plan will provide the named fiduciary with both the authority and a process to enter into contractual fiduciary-outsourcing arrangements for various fiduciary functions.

If a named fiduciary allocates or delegates its fiduciary responsibilities pursuant to a 405(c) fiduciary services agreement, then the co-fiduciary liability of the named fiduciary for the acts or omissions of the persons to whom fiduciary responsibilities have been allocated or delegated is narrowed in scope by section 405(c)(2). Due to a curious cross-reference at the end of this section, the named fiduciary appears to remain subject to joint and co-fiduciary liability under the fault-based circumstances described in section 405(a).[140] Section 405(c)(2) provides:

> If a plan expressly provides for a procedure described in [section 405(c)(1)], and pursuant to such procedure any fiduciary responsibility of a named fiduciary is allocated to any person, or a person is designated to carry out any such responsibility, then such named fiduciary *shall not be liable* for an act or omission of such person in carrying out such responsibility *except to the extent that*—
>
> (A) the named fiduciary violated [section 404(a)(1)]—
>
> (i) with respect to such allocation or designation,
>
> (ii) with respect to the establishment or implementation of the procedure under [section 405(c)(1)], or
>
> (iii) in continuing the allocation or designation; or
>
> (B) the named fiduciary would otherwise be liable in accordance with [section 405(a)].[141]

ERISA's legislative history elaborates on the specific duties of a named fiduciary who allocates or delegates fiduciary duties under section 405(c)(2)(A):

> [I]n implementing the procedures of the plan, plan fiduciaries must act prudently and in the interests of participants and beneficiaries. The fiduciaries also must act in this manner in choosing the person to whom they allocate or delegate their duties. Additionally, they

139. *Id.* § 1105(c)(1).

140. *Id.* § 1105(a).

141. *Id.* § 1105(c)(2) (emphasis added).

must act in this manner in continuing the allocation or delegation of their duties.

In order to act prudently in retaining a person to whom duties have been delegated, it is expected that the fiduciary will periodically review this person's performance. Depending upon the circumstances, this requirement may be satisfied by formal periodic review (which may be by all the named fiduciaries who have participated in the delegation or by a specially designated review committee), or it may be met through day-to-day contact and evaluation, or in other appropriate ways. Since effective review requires that a person's services can be terminated, it may be necessary to enter into arrangements which the fiduciary can promptly terminate (within the limits of the circumstances).[142]

Accordingly, section 405(c)(2)(A) imposes a fiduciary duty on the part of the named fiduciary to monitor the performance of the "outsourced" fiduciary and to remove and replace the outsourced fiduciary if that performance fails to meet ERISA's fiduciary standards.[143]

To summarize the ERISA fiduciary-outsourcing rules presented so far, sections 402(b)(2) and 405(c)(1) provide that a plan can be written to authorize a named fiduciary to outsource fiduciary activities. Section 405(c)(2)(A), by virtue of its cross-reference to the primary fiduciary duties of section 404, indicates that if the outsourcing is done loyally and prudently, and in accordance with the terms of the plan, both initially in selecting the outsourced fiduciary and in periodically reviewing the fiduciary's performance, the named fiduciary is not liable as a co-fiduciary for the acts or omissions of the outsourced fiduciary.

So what might the cross-reference at the end of section 405(c)(2)(B)—that the named fiduciary can be otherwise liable under section 405(a)—contribute to the statutory scheme in terms of regulating fiduciary outsourcing activities? The answer to this question lies in section 405(a), which imposes secondary co-fiduciary duties and related liabilities on plan fiduciaries.

2. Fault-Based, Co-Fiduciary Liability Under Section 405(a)

Section 405(a) establishes three general rules for fault-based, co-fiduciary liability,[144] which are important because if a named fiduciary outsources fiduciary functions, but violates the section 405(a) rules, then the

142. H.R. REP. NO. 93-1280, at 301 (1974) (Conf. Rep.); *see also* 29 C.F.R. § 2509.75–8 (2015).

143. *See* 29 U.S.C. § 1105(c)(2)(A).

144. *Id.* § 1105(a).

fiduciary can be held jointly and severally liable for the misconduct of the co-fiduciary.[145] The three co-fiduciary duties are:

> (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;
>
> (2) if, by his failure to comply with [subsection 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
>
> (3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.[146]

Although sections 405(a)(1) and 405(a)(3) are both based on "knowledge" of a breach by a co-fiduciary, the standards for this knowledge are not identical. Section 405(a)(1) requires "knowledge" by the co-fiduciary that the other fiduciary is committing or has committed a breach of duty. Federal courts generally construe this language, "participates knowingly in, or knowingly undertakes to conceal," as requiring actual knowledge by the co-fiduciary of the fiduciary's breach of duty.[147] This case law, however, is fairly old and relatively sparse.

Section 405(a)(3) imposes liability if the co-fiduciary "has knowledge of a breach by such other fiduciary." Its language is sufficiently different from section 405(a)(1) that some federal courts have suggested that constructive knowledge by the fiduciary, based on a should-have-known standard, suffices under section 405(a)(3).[148] Other federal courts disagree, holding that section 405(a)(3) requires actual knowledge of a fiduciary's breach of duty before the co-fiduciary duty to make reasonable efforts to remedy the prior breach arises.[149] But again, the case law in this area is fairly old and relatively sparse.

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145. *See, e.g.*, Leister v. Dovetail, Inc., 546 F.3d 875, 878 (7th Cir. 2008); LaScala v. Scrufari, 479 F.3d 213, 220 (2d Cir. 2007).

146. 29 U.S.C. § 1105(a) (2012).

147. *See* Willett v. Blue Cross & Blue Shield of Ala., 953 F.2d 1335, 1341–42 (11th Cir. 1992); Donovan v. Cunningham, 716 F.2d 1455, 1475 (5th Cir. 1983); Silverman v. Mut. Benefit Life Ins. Co., 941 F. Supp. 1327, 1335 (E.D.N.Y. 1996); Davidson v. Cook, 567 F. Supp. 225, 237 (E.D. Va. 1983), *aff'd*, 734 F.2d 10 (4th Cir. 1984).

148. *See Silverman*, 941 F. Supp. at 1337; Donovan v. Williams, 4 EBC 1237, 1245 (N.D. Ohio 1983).

149. *See* Lee v. Burkhart, 991 F.2d 1004, 1011 (2d Cir. 1993); *Cunningham*, 716 F.2d at 1475; Keach v. U.S. Tr. Co., 240 F. Supp. 2d 840, 844 (C.D. Ill. 2002); *Davidson*, 567 F. Supp. at 237.

Section 405(a)(2) does not require any knowledge of the fiduciary's breach of duty.[150] Under this rule, a fiduciary is jointly and severally liable for another co-fiduciary's breach if there is a causal connection between the fiduciary's own breach of a primary fiduciary duty under section 404(a)(1) "in the administration of his specific responsibilities which give rise to his status as a fiduciary" and the harm or injury caused by the other co-fiduciary's breach. A few courts have held that co-fiduciary breaches under section 405(a)(2) flow from the fiduciary's own duty of prudence, particularly the duty to monitor appointed fiduciaries, in administering the plan.[151]

Given that section 405(c)(2)(A) describes specific duties about selecting an outsourced fiduciary and reviewing its performance, several questions remain unresolved. Does the general liability provision of section 405(a)(2) impose additional monitoring duties on the named fiduciary regarding an outsourced co-fiduciary? Or, where a 405(c) fiduciary services agreement exists, do the more specific criteria of section 405(c)(2)(A) limit the scope of the named fiduciary's duty to monitor? Is section 405(a)(2) just a "catch-all" backstop for out of the ordinary situations, or does section 405(a)(2) reinforce the duty to monitor under the prudence rule of section 404(a)(1)(B)? The statute is simply unclear. As discussed in Part IV, these ambiguities are important areas for additional regulatory guidance.[152]

As a matter of regulatory policy, if an employer who sponsors a plan can engage in complete outsourcing by amending the plan to designate someone who is unrelated to the employer as the plan's section 402(a) named fiduciary, then these knowledge-and-monitoring-duty ambiguities can be bypassed entirely. It is for this reason that the EBSA Advisory Council characterized outsourcing the section 402(a) named fiduciary function as the "critical foundational issue" for the future of ERISA fiduciary outsourcing.[153] There are considerable policy arguments for and against complete outsourcing as a permissible technique for employers to avoid all fiduciary responsibility for their employee benefit plans.

B. Complete Outsourcing

Complete outsourcing represents the proverbial bottom of the "slippery-slope" effect that results from mechanically applying the settlor function doctrine. In a complete outsourcing situation, the employer who sponsors the plan effectively severs plan sponsorship from the employment relationship by

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150. *See* Free v. Briody, 732 F.2d 1331, 1335 (7th Cir. 1984); Pension Benefit Guar. Corp. v. Ross, 781 F. Supp. 415, 419–20 (M.D.N.C. 1991); Freund v. Marshall & Ilsley Bank, 485 F. Supp. 629, 640 (W.D. Wis. 1979).

151. *See* Kling v. Fid. Mgmt. Tr. Co., 323 F. Supp. 2d 132, 144–45 (D. Mass. 2004); Jackson v. Truck Drivers' Union Local 42 Health & Welfare Fund, 933 F. Supp. 1124, 1141 (D. Mass. 1996); Mazur v. Gaudet, 826 F. Supp. 188, 190–93 (E.D. La. 1992).

152. *See* discussion *infra* Part IV.B.4.

153. ADVISORY COUNCIL REPORT, *supra* note 2, at 10.

designating an unrelated person to serve as the plan's named fiduciary.[154] This subpart begins with a summary of the policy arguments for and against complete outsourcing. It examines the statutory language, legislative history, statutory syntax, and long-standing EBSA interpretations and lower federal court decisions to ascertain whether complete outsourcing as an exculpatory technique is valid, or whether it is a misuse of the settlor function doctrine. It concludes that, as a matter of public policy, employers should be allowed to engage in complete outsourcing as a means of gaining increased efficiency and expertise in plan administration, but that they should be required to retain the ultimate fiduciary responsibility for selecting and retaining the section 402(a)-named fiduciary for the employer's plan.

1. The Policy Benefits and Pitfalls of Complete Outsourcing

Congress attempted to strike a balance between protective and cost-control policy goals when it drafted ERISA.[155] From a policy perspective, outsourcing fiduciary functions associated with operating and administrating the plan has the potential to promote both of these policy objectives.[156] For an employer who sponsors an employee benefit plan, the work of administering the plan may prove too burdensome unless the employer can outsource fiduciary functions. If expert professional fiduciaries are able to execute the specialized fiduciary functions necessary for administering the plan and managing its assets with a higher degree of competence and at a lower cost than the employer who sponsors the plan, then both the plan participants and the plan's sponsoring employer are better off. In addition, particularly in the welfare benefit plan context, if the outsourcing arrangement can be structured so that a third-party fiduciary with discretionary authority to pay participants' claims does not have a pecuniary structural conflict of interest in authorizing payment, then the number of wrongful denials of valid claims may be reduced.[157]

Despite these benefits, complete outsourcing has potential pitfalls. The most obvious danger is the risk of financial mismanagement of the plan's assets by the third-party fiduciary—a risk that Congress designed ERISA to guard against.[158] Investment losses (including lost investment opportunity

154. *See* discussion *infra* Part III.B.2.

155. *See supra* notes 70–72 and accompanying text.

156. *See supra* notes 70–71 and accompanying text.

157. For a detailed historical review of the problems associated with wrongfully denied claims in the context of insured long-term care benefits, see generally Langbein, *supra* note 89. The Supreme Court's subsequent decision in *Metropolitan Life Insurance. Co. v. Glenn*, 554 U.S. 105, 108 (2008), which directed the lower federal courts to weigh the fiduciary's structural conflict as "a factor" in reviewing a participant's wrongful denial of benefits claim under 29 U.S.C. § 1132(a)(1)(B), mitigates but does not eliminate the problem of opportunistic behavior described in Professor Langbein's article.

158. *See supra* note 78 and accompanying text.

losses) caused by breaching a fiduciary duty are not covered by ERISA's bond requirement for fiduciaries, which only guards against the theft of plan assets.[159] Moreover, there is no requirement that a fiduciary must carry insurance, or have sufficient assets to protect the plan's participants against an insolvent fiduciary whose breach of fiduciary duty results in a loss to the plan. Admittedly, these risks apply equally to an employer who sponsors a plan and serves as the plan's named fiduciary.[160] But the underlying employment relationship between the employer and the plan's participants provides an additional incentive for sound plan operation and administration (separate from avoiding personal ERISA liability for breaching a fiduciary duty[161]) that seems different in degree and kind from the compensation incentive for performance that exists when an employer hires a third-party professional to serve as its plan's named fiduciary. The costs associated with providing employee benefits are a significant percentage of a typical employer's labor costs,[162] and employers view benefit plans as an important recruiting and retention mechanism for employees.[163] These factors give the employer a unique motivation to operate and administer the plan with a longer-term perspective on employee satisfaction that may not be present for a professional fiduciary who operates the plan based on a short-term 405(c) fiduciary services agreement.[164]

2. The Statutory Basis for Complete Outsourcing

Employers who sponsor pension and welfare benefit plans for their employees traditionally have served as the plan's named fiduciary, either directly by naming the corporate entity as the named fiduciary, or indirectly by naming a committee comprised of internal officers and employees as the

159. *See* 29 U.S.C. § 1112 (2012).

160. The risk that a financial loss to plan assets caused by breaching a fiduciary duty will fall on the employer varies with the type of employee benefit plan. For example, in a defined-benefit pension plan, the employer is responsible for any funding shortfall under ERISA's minimum-funding standards. In an employer self-insured group-health plan, typically the employer will fund at least part of the cost of the health-care benefits the plan provides. In a defined-contribution plan, the employer may be required to make a contribution to the participants' accounts, but may or may not be responsible for investing the account balances.

161. *See* 29 U.S.C. § 1109(a) (imposing personal liability for a breach of fiduciary duty).

162. *See supra* text accompanying note 3.

163. *See Benefits Take On New Importance in Recruiting and Retaining Employees, SHRM Survey Finds*, SOC'Y HUM. RESOURCE MGMT. (Oct. 15, 2015), https://www.shrm.org/about-shrm/press-room/press-releases/Pages/2015_Strategic_Benefits_Survey.aspx (discussing the results of its 2015 Strategic Benefits Series Survey).

164. *See* Sarah E. Downie, *Request for Proposal (RFP) Checklist for Retirement Plans*, PRAC. L., http://us.practicallaw.com/7-518-7857 (last visited Oct.21, 2016) ("While an RFP is a significant undertaking, many plan fiduciaries conduct a 'due diligence' RFP every three to five years to help them make informed decisions and to comply with their ERISA fiduciary responsibilities.").

named fiduciary.[165] The statutory language of section 402(a), however, does not expressly require this employment relationship. Section 402(a) provides:

> (1) Every employee benefit plan shall be established and maintained pursuant to a written instrument. Such instrument shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan.
>
> (2) For purposes of [Title I of ERISA], the term "named fiduciary" means a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary (A) by a person who is an employer or employee organization with respect to the plan or (B) by such an employer and such an employee organization acting jointly.[166]

The passive-voice sentence construction in section 402(a)(1), coupled with the circular definition of a "named fiduciary" in section 402(a)(2), means that this statutory language can be read to indicate that employers could designate literally anyone as the named fiduciary in the plan document.[167] If so—and if the establishment or amendment of the plan document is a nonfiduciary act by the plan's sponsoring employer under the settlor function doctrine—then the employer can outsource all of its federal fiduciary responsibility for the plan.[168] In a nutshell, this two-step analysis is the case for complete outsourcing as an exculpatory technique for the employer who sponsors an ERISA-regulated plan.

But did Congress really intend that anyone could serve as a plan's named fiduciary? The circular definition of a named fiduciary in section 402(a)(2) requires looking to other provisions of ERISA for instruction.[169] Understanding why Congress might have used this odd passive-voice sentence construction in section 402(a)(1) and a circular definition of a named fiduciary in section 402(a)(2) requires examining the broader historical context in which Congress enacted ERISA.

3. Legislative History

Until now, this Article has considered only a single private employer who sponsors a single-employer plan solely for its own employees as the governing

165. *See* ADVISORY COUNCIL REPORT, *supra* note 2, at 4 ("In recent years, there has also been a trend to outsource functions that have been traditionally performed by the plan sponsor or a person acting on behalf of the plan sponsor."); Medill, *supra* note 59, at 274–75, 274 n.138.

166. 29 U.S.C. § 1102(a)(1)–(2) (2012).

167. ADVISORY COUNCIL REPORT, *supra* note 2, at 10.

168. *See id.*

169. *See* Yates v. Hendon, 541 U.S. 1, 12 (2004) ("ERISA's nominal definition of 'employee' as 'any individual employed by an employer' is completely circular and explains nothing." (quoting Nationwide Mut. Ins. v. Darden, 503 U.S. 318, 323 (1992)).

paradigm for discussion purposes. Many employee benefit plans subject to regulation under ERISA are sponsored by a single employer solely for its own employees.[170] But when Congress enacted ERISA, it was equally (if not more) concerned with mismanagement problems involving plan assets that had persisted in the labor union context of multiemployer plans.[171] A multiemployer plan is a plan sponsored by more than one employer pursuant to the terms of a collective-bargaining agreement that is negotiated between each participating employer and a labor union.[172] The participants in the multiemployer plan are the employees of different employers, all of whom are members of the collective-bargaining unit represented by the union.[173] A board of trustees, comprised of an equal number of representatives from management and labor, administer multiemployer plans,[174] which are operated in accordance with section 302 of the Labor Management Relations Act of 1947 (also known as the "Taft–Hartley Act").[175]

With this background in mind, the congressional Conference Report explains the purpose of the named fiduciary requirement of section 402(a) as follows:

> Under [ERISA section 402], every covered employee benefit plan (both retirement and welfare plan) is to be established and maintained in writing. A written plan is to be required in order that every employee may, on examining the plan documents, determine exactly what his rights and obligations are under the plan. Also, a written plan is required so the employees may know who is responsible for operating the plan. Therefore, the plan document is to provide for the "named fiduciaries" who have authority to control and manage the plan operations and administration. A named fiduciary may be a person whose name actually appears in the document, or may be a person who holds an office specified in the document, such as the company president. A named fiduciary also may be a person who is identified by the employer or union, under a procedure set out in the document. For example, the plan may provide that the employer's board of directors is to choose the person who manages or controls the plan. In addition, a named fiduciary may be a person identified by the employers and union

170. 29 U.S.C. § 1002(41) (defining a single employer plan as one that is not a multiemployer plan).

171. *See* H.R. REP. NO. 93-533, at 2–8 (1973); S. REP. NO. 93-127, at 2–7 (1973); *see supra* note 78 and accompanying text.

172. 29 U.S.C. § 1002(37)(A) (2012).

173. *See id.* § 1002(37)(A)(ii).

174. *See id.* § 1002(16)(B)(ii).

175. *See id.* § 186.

acting jointly. For example, the members of a joint board of trustees of a Taft-Hartley plan would usually be named fiduciaries.[176]

This legislative history is inconclusive about who can serve as the named fiduciary of a single-employer plan. On the one hand, the Conference Report indicates that any person designated by the plan could serve as the named fiduciary, or the employer's board of directors could select any person to serve as the plan's named fiduciary.[177] On the other, the Conference Report lists a person who is an officer of the employer, such as the company president, as a specific example.[178] From this example, one might infer that Congress implicitly assumed that the plan's named fiduciary would be a person who was an officer or employee of the employer who sponsored the plan.

Other sections of ERISA's legislative history suggest that Congress viewed the operation of employee pension plans as implicitly bound up with the employer and the underlying employment relationship. Both the House Report and the Senate Report list "Vesting" and "Funding" as the first two "major issues" the legislation addressed.[179] Both vesting and funding are intrinsically connected with the employer and the employment relationship. Under ERISA, an employee accumulates a year of service towards the plan's vesting schedule based on the number of hours of service with the employer during the measuring year for single-employer plans.[180] Plan funding is an employer obligation for a defined benefit plan,[181] which was the dominant type of pension plan when Congress enacted ERISA in 1974.[182] Although Congress's concerns with vesting and funding may be considered peripheral to interpreting the named fiduciary requirement, these contemporaneous major policy issues indicate the importance of the employment relationship to plan sponsorship.

Viewed in this larger legislative policy context, it seems unlikely that Congress expressly intended that employers could sever the employment relationship by designating an unrelated third party as the plan's named fiduciary. A more plausible interpretation of this legislative history is that Congress simply never envisioned a complete outsourcing scenario, let alone cleverly drafting a passive-voice construction to permit complete outsourcing as an exculpatory technique for employers who sponsor benefit plans.

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176. H.R. REP. NO. 93-1280, at 297 (1974) (Conf. Rep.).

177. *See id.*

178. *See id.*

179. H.R. REP. NO. 93-533, at 5–7 (1973); S. REP. NO. 93-127, at 8–10 (1973).

180. *See* 29 U.S.C. § 1053 (2012).

181. *See id.* §§ 1081–1085a.

182. *See* LaRue v. DeWolff, Boberg & Assocs., Inc., 552 U.S. 248, 254–56 (2008). As a backstop for funding inadequacies, ERISA also created a separate agency, the Pension Benefit Guaranty Corporation, to insure the benefits promised under a defined benefit plan. *See* 29 U.S.C. §§ 1301–1310.

Advocates for complete outsourcing are likely to counter that courts should give ERISA's legislative history less weight in interpreting the statute because the world of employee benefit plans, on both the pension- and welfare-benefit sides, has changed dramatically since 1974.[183] Moreover, as evidenced by *Tibble v. Edison International*, it is in the context of today's popular and highly prevalent 401(k) plan—a type of plan that was not even in existence in 1974[184]—where using an outside professional fiduciary as the plan's named fiduciary is particularly appealing to employers due to the multimillion dollar liability risk associated with monitoring the plan's menu of investment options.[185] Do changes in the world of employee benefit plans, particularly the emergence of the 401(k) plan,[186] render ERISA's legislative history obsolete? This possibility suggests that a closer examination of section 402(a) in the overall context of both ERISA and the IRC, which governs tax-favored pension plans, is warranted.

4. Statutory Syntax, Agency, and Judicial Interpretations

As the Supreme Court has noted several times, ERISA is a "comprehensive and reticulated statute"[187] that is "enormously complex and detailed."[188] These characteristics have led the Court in the context of pension and welfare benefit plans to eschew a plain-language reading in favor of a contextual "statutory syntax" or "whole act" approach. Using this contextual form of statutory analysis, the Court interprets a specific provision of a complex federal statute in a manner that is the most consistent with other statutory provisions, the overarching legislative purpose of ERISA and, where applicable, the IRC.

CIGNA Corp. v. Amara illustrates the "whole act" approach in the pure ERISA context. *Amara* was a complex case involving a simple claim that the plan administrator had misled participants by providing inaccurate required information about a reduction in their benefits as a result of a plan amendment.[189] The district court held that the summary plan descriptions of the benefits provided under the new plan given to the participants were "significantly incomplete and misled [the] employees."[190] It ordered that the terms of the new plan be reformed so that participants would receive both their "old plan" accrued benefits to date, plus their "new plan" benefits, as the

183. *See LaRue*, 552 U.S. at 254–56 (describing the industry shift in retirement plans from defined benefit to defined contribution).

184. *See* Medill, *supra* note 124, at 7 nn.25–26.

185. *See infra* notes 233–41.

186. *See* Medill, *supra* note 124, at 7–9.

187. Nachman Corp. v. Pension Benefit Guar. Corp., 446 U.S. 359, 361 (1980).

188. Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 447 (1999) (quoting Mertens v. Hewitt Assocs., 508 U.S. 248, 262 (1993)).

189. CIGNA Corp. v. Amara, 563 U.S. 421, 424–34 (2011).

190. *Id.* at 428.

employer's misleading summary plan descriptions had suggested.[191] The district court then ordered that the terms of the plan, as reformed by the court's order, be enforced under section 502(a)(1)(B) of ERISA, which authorizes a claimant to "recover benefits due to him under the terms of his plan."[192]

As a result of the district court's remedy, the statutory interpretation question in *Amara* centered on the meaning of "plan" under section 502(a)(1)(B). The Solicitor General, arguing in support of the district court's order, urged the Supreme Court to view the misleading summary plan descriptions as part of the "plan" for the purposes of the remedy authorized under section 502(a)(1)(B).[193] Relying on statutory syntax, the Supreme Court ultimately rejected this analysis by examining the interrelated functions of other statutory provisions of ERISA and concluding that the Solicitor General's suggested interpretation of section 502(a)(1)(B) was inconsistent with the meaning and purpose of these other provisions of the statute. [194]

The Supreme Court's recent decision in *King v. Burwell*[195] provides an even more dramatic example of how statutory syntax in a complex statutory scheme can trump the plain language of an isolated statutory provision. *King v. Burwell* involved a challenge to a regulation promulgated by the Internal Revenue Service ("IRS") under section 36B of the IRC.[196] This section, which Congress enacted as part of the Patient Protection and Affordable Care Act,[197] authorized paying premium assistance tax credits to qualifying taxpayers who enrolled in an insurance plan through "an Exchange established by the State."[198] The question presented in *King v. Burwell* was "whether the [Affordable Care] Act's tax credits are available in States that have a Federal Exchange."[199] The Supreme Court held that "*the context and structure of the Act*

191. *Id.* at 433.

192. *Id.* at 434 (quoting 29 U.S.C. § 1132(a)(1)(B) (2012)).

193. *Id.* at 436.

194. *Id.* at 436–38. Specifically, the Supreme Court found that interpreting the "plan" as including the terms of the misleading summary plan descriptions would be inconsistent with: (1) section 102(a)'s requirement that a plan administrator must furnish a summary plan description to the plan participants that is a separate document from and not part of "the plan"; (2) section 402's requirement that a plan can only be amended by the plan settlor pursuant to the formal procedure set forth in the plan document and cannot be amended indirectly by the plan administrator simply by inserting different terms in the summary plan description; and (3) section 102(a)'s requirement that summary plan description language must communicate the benefits provided under the plan in clear and simple language to the plan participants and is not intended to be a technical description of all of the technical terms of the plan. *See id.*

195. *See generally* King v. Burwell, 135 S. Ct. 2480 (2015).

196. 26 U.S.C. § 36B; *King*, 135 S. Ct. at 2487 (2012).

197. Patient Protection and Affordable Care Act, Pub. L. No. 111–148, 124 Stat. 119 (2010) (as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111–152, 124 Stat. 1029 (2010)).

198. 26 U.S.C. § 36B(b)(2) (2012).

199. *King*, 135 S. Ct. at 2485.

compel us to depart from what would otherwise be the most natural reading of the pertinent statutory phrase."[200] Relying on evidence that withholding tax credits from qualifying individuals in federal Exchange states would result in a "death spiral" of rising health insurance rates, the Supreme Court concluded that:

> Congress passed the Affordable Care Act to improve health insurance markets, not to destroy them. If at all possible, we must interpret the Act in a way that is consistent with the former, and avoids the latter. Section 36B can fairly be read consistent with what we see as Congress's plan, and that is the reading we adopt.[201]

Finally, interpreting key definitions for ERISA-regulated, tax-favored pension plans (so-called "qualified plans" that satisfy all of the requirements of IRC section 401(a)) requires analysis of both ERISA and the IRC, because an ERISA pension plan that is also a tax-favored qualified plan must satisfy both sets of statutory rules.[202] *Yates v. Hendon* provides an illustration of a complex analysis involving both statutes.[203] In *Yates*, the Supreme Court was tasked with interpreting another one of ERISA's circular definitions, namely whether a working owner of the business that sponsored the plan qualified as a "participant," and was therefore entitled to the protection against creditors provided by ERISA's anti-alienation rule.[204] In addition to these ERISA statutory provisions, the Supreme Court examined extensively the relevant provision of section 401(a), which sets forth the requirements for qualified plans, before concluding that a working owner should be protected as a "participant" in the employer's plan under the ERISA definition.[205]

With the "whole act" approach of these Supreme Court precedents in mind, is it possible for an employer who sponsors an ERISA pension plan that is also a qualified plan under IRC section 401(a) to escape entirely the fiduciary responsibility for its operation by designating an outside professional fiduciary as the plan's named fiduciary in the plan document? Although the named fiduciary requirement is an ERISA rule that applies equally to both pension and welfare benefit plans, any interpretation of these requirements must be consistent with the relevant provisions of the IRC that govern qualified retirement plans. Consequently, the key IRC provisions applicable to the pension side of the ERISA equation also bear on the appropriate interpretation of ERISA's named-fiduciary requirement.

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200. *Id.* at 2495 (emphasis added).

201. *Id.* at 2496.

202. *See* Yates v. Hendon, 541 U.S. 1, 13 (2004) (stating that "Congress' objective [enacting ERISA] was to harmonize ERISA with longstanding tax provisions" that governed "tax-favored pension plans").

203. *Id.*

204. *See id.* at 6–11.

205. *See id.* at 12–18.

The introduction to IRC section 401(a) states only that "[a] trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section if [the following 37 requirements are satisfied]."[206] Thus, IRC section 401(a) itself is silent on the named fiduciary requirement. The IRS's long-standing regulatory interpretation of IRC section 401(a), however, is that a qualified plan must be "*established and maintained by an employer*" to provide retirement benefits for its employees.[207] For ERISA-regulated pension and welfare benefit plans, the statutory definitions for an "employee pension benefit plan" in section 1002(2)(A) and an "employee-welfare benefit plan" in section 1002(1) both state that the plan must be "*established or maintained* by an employer or by an employee organization, or by both."[208] Judicial and EBSA interpretations of this parallel ERISA language indicate that an employment-based common nexus, unrelated to the provision of plan benefits, must exist between the entity that "establishes and maintains" the plan and the plan's participants.

This "established and maintained" requirement has led to attempts by third parties on both the welfare benefit plan and the pension plan sides to set up arrangements where a third party establishes and administers a plan for multiple unrelated employers who, unlike in the multiemployer context, are not parties to a unifying collective-bargaining agreement under federal labor law. In these multiple employer arrangements, each unrelated employer agrees to "subscribe" or "co-sponsor" the multiple employer plan, with the third party serving as the plan's named fiduciary. The third party who operates the multiple employer plan claims that the arrangement satisfies ERISA. Both the federal courts and the EBSA have rejected these types of arrangements for failing to satisfy the ERISA definition of a welfare benefit plan under section 3(1), or a pension benefit plan under section 3(2).[209]

Two early cases involving multiple employer welfare benefit arrangements, *Wisconsin Education Association Insurance Trust v. Iowa State Board of Public Instruction*[210] and *MDPhysicians & Associates, Inc. v. State Board of Insurance*,[211] established key precedents regarding the legality of these arrangements under ERISA. As the Eighth Circuit explained in *Wisconsin Education Association Insurance Trust*:

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206. 26 U.S.C. § 401(a) (2012).

207. *See* 26 C.F.R. § 1.401–1(b)(1)(i) to (iii) (2016) (emphasis added).

208. *Compare* 29 U.S.C. § 1002(2)(A) (2012) (emphasis added), *with* 29 U.S.C. § 1002(1) (emphasis added).

209. *See* discussion *infra* text and accompanying notes 210–20.

210. *See generally* Wis. Educ. Ass'n Ins. Tr. v. Iowa State Bd. of Pub. Instruction, 804 F.2d 1059 (8th Cir. 1986).

211. *See generally* MDPhysicians & Assocs., Inc. v. State Bd. of Ins., 957 F.2d 178 (5th Cir. 1992).

> The definition of an employee welfare benefit plan is grounded on the premise that the entity that maintains the plan and the individuals that benefit from the plan are tied by a common economic or representation interest, unrelated to the provision of benefits. An employee depends on his employer; a union member relies on his union. This nexus is non-existent under [the third party's interpretation of section 3(1)].[212]

The Fifth Circuit in *MDPhysicians & Associates, Inc.* agreed, and elaborated on the reasoning that underlies the "common-nexus" requirement:

> [W]e know that the MDP Plan, as a [multiple employer welfare arrangement], offered or provided certain medical and health benefits to the Employees of the multiple Subscribing Employers. But we also understand that the Subscribing Employers did not establish the MDP Plan, nor did they "participate in the day-to-day operation or administration of the plan"; rather *MDP* established and maintained the MDP Plan, at least in terms of the Plan's status as a "multiple employer welfare arrangement." . . .
>
> Next, we consider the relationship between the provider of benefits, MDP, and the recipients of those benefits under the Plan, the Employees of Subscribing Employers. We agree with the Eighth Circuit, which reads the pertinent definitions as requiring "that the entity that maintains the plan and the individuals that benefit from the plan [be] tied by a common economic or representation interest, *unrelated to the provision of benefits*." The most common example is the economic relationship between employees and a person acting directly as their employer.[213]

More recently, a similar multiple employer arrangement on the pension plan side has been rejected by the EBSA for failing the section 3(2) definition of an employee pension plan. In Advisory Opinion Letter 2012-04A, the EBSA addressed an arrangement (the "Advantage 401(k) Plan") that a third party ("Advantage") had established. At the time the EBSA issued its letter, the Advantage Plan had over 500 unrelated participating employers, over 9,800 participants, and approximately $63 million in assets.[214] The Advantage 401(k) Plan was administered with the assistance of a registered investment advisory firm ("TAG"). The Advantage 401(k) Plan was:

212. *Wis. Educ. Ass'n Ins. Tr.*, 804 F.2d at 1063.

213. *MDPhysicians & Assocs., Inc.*, 957 F.2d at 185–86 (citations omitted).

214. EBSA Adv. Op. Ltr. 2012-04A, at 1 (May 25, 2012), https://www.dol.gov/sites/default/files/ebsa/employers-and-advisers/guidance/advisory-opinions/AO2012-04A_0_0.pdf [hereinafter "EBSA Adv. Op. Ltr. 2012-04A"].

> intended to be a single "multiple employer" 401(k) profit-sharing plan covering employees of Advantage as well as employees of other unrelated employers that adopt the Plan. The current participation agreement form describes each participating employer as acting "directly as an employer" and as a "co-sponsor" of the Advantage Plan. . . .

TAG is designated as the administrator, within the meaning of ERISA section 3(16), of the Plan. Advantage signs the Forms 5500 filed for the Plan as the "'plan sponsor'. . . . Advantage is also the 'named fiduciary' for the Advantage Plan, and "assumes the risk and liability associated with the trustee role and removes every adopting employer from the liability associated with that role."[215]

Considering the validity of this arrangement as an "employee pension plan" under section 3(2) of ERISA, the EBSA found that although the Advantage 401(k) Plan did provide pension benefits to its participants, the plan's sponsor Advantage was not acting as an employer within the meaning of section 3(5) of ERISA.[216] In addition, the EBSA found that the Advantage 401(k) Plan lacked an employment-based common nexus unrelated to the provision of benefits between Advantage or TAG and the employees who received benefits from the Plan.[217] The EBSA characterized the relationship between Advantage and TAG and the Advantage 401(k) Plan not as plan sponsors, but rather as plan service providers (i.e., a third-party administrator and an investment advisor).[218] According to the EBSA, this interpretation requiring that an ERISA plan must be sponsored in reality by an employer was supported by both prior judicial and administrative agency precedent:

> This conclusion reflects the established judicial view that the person or group maintaining an "employee benefit plan" under ERISA must be tied to the employees or the contributing employers by genuine economic or representational interests unrelated to the provision of benefits. These common employment-based interests distinguish an employee benefit plan from other entities that underwrite benefits or provide administration services. The [EBSA] has long adhered to this interpretation of ERISA.[219]

In a crucial passage, Advisory Opinion Letter 2012–04A emphasizes the substantive nature of plan sponsorship by making clear that an employer must sponsor the plan in fact, and not just on paper:

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215. *Id.* at 1.

216. Section 3(5) defines an employer as "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity." 29 U.S.C. § 1002(5) (2012).

217. EBSA Adv. Op. Ltr. 2012-04A, *supra* note 214, at 3–4.

218. *See id.* at 5.

219. *Id.* at 5 (citation omitted).

> In your submission, you assert that there is no need for a bona fide employer group or association or for any person to be acting indirectly in the interest of the direct employers because each employer who enters into a participation agreement with TAG to provide benefits to its employees through the Advantage Plan will be acting as a Plan "co-sponsor," and "acting directly on its own behalf" in separately adopting a "multiple employer" defined contribution plan for its own employees. As described above, the mere execution of identically worded trust agreements or similar documents by unrelated employers as a means to fund or provide benefits for their employees, is not a sufficient basis for concluding that the employers have established or maintain a single plan for purposes of ERISA. Participation agreements that label the signatory employers as co-sponsors of a plan do not change this conclusion.[220]

The employment-based nexus contemplated by the EBSA in Advisory Opinion Letter 2012-04A is mirrored in the major IRC requirements for qualified plans, many of which are duplicated by ERISA provisions that regulate employee benefit plans. First, only employees and their beneficiaries—and not independent contractors—can participate in the plan.[221] Second, initial eligibility to participate in the plan is determined by hours of service with the employer, measured initially from the employee's employment commencement date.[222] Vesting in plan benefits funded by the employer is based on hours of vesting service with the employer.[223] Funding is an employer obligation for profit-sharing, stock bonus, and defined benefit plans,[224] and even participant salary deferral contributions to a 401(k) plan are characterized as employer contributions.[225] Finally, the employer is responsible in a single-employer defined benefit plan for paying annual premiums for insurance coverage of the plan's benefits by the Pension Benefit Guaranty Corporation.[226] In short, the IRC and ERISA requirements for tax-favored pension plans indicate that there must be significant employer responsibility for *maintaining* the plan.

But employer responsibility for maintaining the plan does not necessarily dictate that the employer also must operate and administer the plan. The critical policy question presented when an employer uses the complete outsourcing technique is whether the employer's conduct in selecting and

220. *Id.* (citation omitted).

221. *See* 26 U.S.C. § 401(a) (2012); 29 U.S.C. § 1003(a)(3); Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 322–23 (1992) (using the common law agency test developed under the IRC to define an "employee" under ERISA).

222. *See* 26 U.S.C. §§ 401(a)(3), 410(a); 29 U.S.C. § 1052.

223. *See* 26 U.S.C. §§ 401(a)(7), 411(a); 29 U.S.C. § 1053.

224. *See* 26 U.S.C. § 412(e)(2); 29 U.S.C. §§ 1082–1083.

225. *See* 26 U.S.C. § 401(k)(2)(A).

226. *See* 29 U.S.C. § 1307.

retaining the third party as the plan's section 401(a) named fiduciary is a fiduciary action subject to ERISA's fiduciary standards, or a nonfiduciary settlor action that is outside the jurisdiction of ERISA's standards for fiduciary conduct. The Supreme Court's settlor function doctrine precedents shed light on this regulatory policy question.

5. Reexamining the Settlor Function Doctrine

Just as statutory syntax is critical for interpreting a particular statutory provision, the factual context of a Supreme Court decision is critical for assessing its precedential impact. This principle is particularly true for the Supreme Court's ERISA jurisprudence, where the Court has frequently revised or clarified broad holdings in early cases through subsequent decisions. Examples include interpretation of ERISA preemption of state laws under section 514(a),[227] claims against nonfiduciaries under section 502(a)(3),[228] and claims for breach of fiduciary duty under section 502(a)(2).[229] The Supreme Court's holdings in *Spink* and *Hughes Aircraft* regarding the scope of the settlor function doctrine appear ripe for similar clarification in light of the emergence of complete outsourcing as an exculpatory technique.

As an initial observation, recall from Part II.C that the factual setting in both *Spink* and *Hughes Aircraft* involved a plan amendment that changed the benefits provided under the plan.[230] In the key passages from both *Spink* and *Hughes Aircraft*, the Supreme Court distinguished these plan benefit amendments—which are nonfiduciary acts by the employer who sponsors the plan—from the core fiduciary functions under section 3(21)(A) of plan administration and management. According to *Spink*, the settlor function doctrine

> is rooted in the text of ERISA's definition of [a functional] fiduciary [under section 3(21)(A)]. . . . [O]nly when fulfilling certain defined functions, *including the exercise of discretionary authority or control over plan management or administration, does a person become a fiduciary under § 3(21)(A).* Because the defined functions in the definition of

227. *Compare* Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 96–100 (1983) (explaining that Congress intended broad preemption of state laws), *with* N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 654–55 (1995) (clarifying that Congress did not intend to supersede states' historic police powers).

228. *Compare* Mertens v. Hewitt Assocs., 508 U.S. 248, 253–55 (1993) (indicating that claims under section 502(a)(3) cannot be brought against a nonfiduciary), *with* Harris Tr. & Sav. Bank v. Solomon Smith Barney, Inc., 530 U.S. 238, 248–49 (2000) (characterizing *Mertens* as dicta and holding that section 502(a)(3) permits claims against nonfiduciaries).

229. *Compare* Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 140–42 (1985) (holding that relief must go to the entire plan as a whole), *with* LaRue v. DeWolff, Boberg & Assocs., Inc., 552 U.S. 248, 253–56 (2008) (holding that *Russell*'s "entire plan" language does not apply to defined contribution plans).

230. *See supra* text accompanying notes 111, 118.

> fiduciary do not include plan design, an employer may decide to amend an employee benefit plan without being subject to fiduciary review.[231]

Spink does not address at all the situation where an employer amends the terms of the plan to designate an outside professional fiduciary as the plan's section 402(a) named fiduciary, the person with ultimate fiduciary authority over administrating and managing the plan. In fact, this passage from *Spink* can be read as supporting the policy position that selecting or retaining the plan's section 402(a) named fiduciary is an inherently fiduciary act under section 3(21)(A) of the ERISA.

Similarly, the key passage in *Hughes Aircraft* can be read as drawing a clear distinction between "pure" plan benefit amendments covered by the settlor function doctrine, and amendments (such as designating a third party as the plan's named fiduciary) that clearly implicate fiduciary duties of plan administration:

> In general, an employer's decision to amend a pension plan concerns the composition or design of the plan itself and does not implicate the employer's fiduciary duties which consist of such actions as the administration of the plan's assets. ERISA's fiduciary duty requirement simply is not implicated where Hughes, acting as the Plan's settlor, makes a decision regarding the form or structure of the Plan such as who is entitled to receive Plan benefits and in what amounts, or how such benefits are calculated.[232]

This contextual analysis suggests that—at least in the context of complete outsourcing—the "holdings" in *Spink* and *Hughes Aircraft* are not actually holdings, but rather are more accurately characterized as dicta instead. Read as dicta, *Spink* and *Hughes Aircraft* do not relieve the employer from ERISA's fiduciary standards when selecting or retaining a section 402(a) named fiduciary for an employer's plan.

The statutory support for this more nuanced reading of *Spink* and *Hughes Aircraft* lies in ERISA section 404(a)(1)(D), which provides that the fiduciary must discharge his duties "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter."[233] Section 410(a) further provides that "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 [4 of Title I of

231. Lockheed Corp. v. Spink, 517 U.S. 882, 890 (1996) (emphasis added) (citations omitted).

232. Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 444 (1999) (citation omitted).

233. 29 U.S.C. § 1104(a)(1)(D) (2012).

ERISA] shall be void as against public policy."[234] In *Fifth Third Bancorp v. Dudenhoeffer,* which was decided after *Spink* and *Hughes Aircraft*, the Supreme Court suggested that these two sections of ERISA, working in tandem, provide an important check on the settlor function doctrine, and do not extend to the situation where the terms of a plan document are used to limit ERISA fiduciary duties. As the *Fifth Third Bancorp* Court reasoned:

> Consider the statute's requirement that fiduciaries act "in accordance with the documents and instruments governing the plan *insofar as such documents and instruments are consistent with the provisions of* [ERISA § 404(a)(1)(D)]. This provision makes clear that the duty of prudence *trumps the instructions of a plan document*, such as an instruction to invest exclusively in employer stock even if financial goals demand the contrary. This rule would make little sense if, as petitioners argue, the duty of prudence is defined by the aims of the particular plan as set out in the plan documents, since in that case the duty of prudence could never conflict with a plan document.[235]

Although *Fifth Third Bancorp* never mentions the settlor function doctrine directly, the last sentence in this quotation indicates that a plan design decision by the plan's sponsoring employer to select or retain a third party as the plan's section 402(a) named fiduciary is still subject to ERISA fiduciary-duty standards. In short, reliance on the settlor function doctrine for the proposition that a plan design is always a nonfiduciary act is contradicted by sections 404(a)(1)(D) and 410(a) of ERISA.[236]

Section 410(a) further contradicts any contractual exculpatory arrangements between an employer and an outside professional fiduciary who has been designated as the plan's section 402(a) named fiduciary, such as the exculpatory language contained in the employer agreements for the Advantage Plan described in Advisory Opinion Letter 2012-04A.[237] Consistent with ERISA's primary protective policy, if the employer who sponsors the plan is contractually relieved from fiduciary responsibility for the plan in its section 405(c) fiduciary services agreement with the outside named fiduciary, section 410(a) should void the risk allocation arrangement as a de facto prohibited exculpatory provision on public policy grounds. This suggested regulatory policy approach—permitting complete outsourcing to enable employers as plan sponsors to realize gains in efficiency and expertise in plan

234. *Id.* § 1110(a).

235. Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459, 2468 (2014) (second emphasis added).

236. *Cf.* Medill, *supra* note 59, at 284–87 (arguing that ERISA sections 404(a)(1)(D) and 410(a) support the application of vicarious fiduciary liability to a corporate employer who designates internal employees as the plan's named fiduciary in the plan document); Muir & Stein, *supra* note 122, at 545–46 (arguing that selection and monitoring of investment options are always fiduciary functions even if the menu of investment options is set forth in the plan document).

237. *See supra* note 215 and accompanying text.

administration, while still subjecting their decision to select and retain a third-party section 401(a) named fiduciary to ERISA fiduciary standards—strikes the appropriate balance between ERISA's primary protective policy and its secondary cost-containment policy.[238]

IV. Regulation of the Private Market for Fiduciary Services

Part III of this Article made the claim that an employer who engages in complete outsourcing may still achieve its benefits of increased efficiency and expertise in plan administration, but must retain the ultimate fiduciary responsibility for the selection and retention of the section 402(a) named fiduciary for the employer's plan. Part IV of the Article attempts to identify and address some of the practical areas of ambiguity where additional regulatory guidance related to fiduciary outsourcing arrangements would strengthen the private market for fiduciary services by clarifying the respective fiduciary responsibilities of the plan's named fiduciary and third-party professional fiduciaries who provide services to the plan.

A. Tibble v. Edison International *and the Duty to Monitor*

In *Tibble v. Edison International*, beneficiaries of the company's 401(k) plan filed suit in 2007 against the company as the plan's named fiduciary and against various individual company officers and employees who served as members of the 401(k) plan's investment committee (collectively, "Edison"). The plaintiffs claimed that Edison had breached the fiduciary duty of prudence under section 404(a)(1)(B) of ERISA by offering six higher-priced, retail-class mutual funds as investment options when "materially identical lower priced institutional-class mutual funds were available" because Edison's plan had over $3 billion in assets.[239] Three of the disputed mutual funds had been added to the plan's line-up of investment options in 1999 and the other three disputed mutual funds had been added in 2002.

For the three funds added to the 401(k) plan in 2002, the district court held that Edison had "not offered any credible explanation" for offering the retail-class higher-fee mutual funds that "cost the Plan participants wholly unnecessary [administrative] fees," and concluded that Edison had breached its duty of prudence by selecting and retaining the funds as investment options.[240] Regarding the three funds added to the plan in 1999, however, the district court held that the same claim was time-barred by ERISA's six-year statute of limitations.[241] The district court allowed the plaintiffs to argue that their complaint was timely because the three 1999 funds underwent significant changes that should have prompted Edison to review its fund

238. *See supra* notes 70–73 and accompanying text.
239. Tibble v. Edison Int'l, 135 S. Ct. 1823, 1826 (2015).
240. *Id.* (alteration in original).
241. *Id.*

menu and convert the higher-priced, retail-class mutual funds to lower-priced, institutional-class mutual funds. Ultimately, however, the district court concluded that "the circumstances had not changed enough to place [Edison] under an obligation to review the mutual funds and to convert them to lower priced institutional-class mutual funds."[242] On appeal, the Ninth Circuit held that the plaintiffs' claims related to the three 1999 mutual funds were untimely because they had not established a change in circumstances sufficient to trigger an obligation to review and to change investments within the six-year statute-of-limitations period.[243]

The Supreme Court granted certiorari on the technical question of whether a fiduciary's allegedly imprudent retention of an investment was an "action" or "omission" that tolled the statute of limitations for an ERISA breach of fiduciary duty claim.[244] Relying on ERISA's fiduciary roots in the common law of trusts, the Court found that the ERISA duty of prudence includes an ongoing duty to monitor, the failure of which can trigger a separate breach of fiduciary duty claim under ERISA:

> [U]nder trust law, a fiduciary normally has a continuing duty of some kind to monitor investments and remove imprudent ones. A plaintiff may allege that a fiduciary breached the duty of prudence by failing to properly monitor investments and remove imprudent ones. . . .
>
> The parties now agree that the duty of prudence involves a continuing duty to monitor investments and remove imprudent ones under trust law. The parties disagree, however, with respect to the scope of that responsibility. Did it require a review of the contested mutual funds here, and if so, just what kind of review did it require? A fiduciary must discharge his responsibilities "with the care, skill, prudence, and diligence" that a prudent person "acting in a like capacity and familiar with such matters" would use. We express no view on the scope of [Edison's] fiduciary duty in this case. We remand for the Ninth Circuit to consider petitioners' claims that [Edison] breached [its] duties . . . recognizing the importance of analogous trust law.[245]

In the wake of *Tibble*'s remand, eight high-dollar, high-profile excessive fee cases that had been in litigation for years suddenly settled, netting one prominent ERISA plaintiffs' law firm negotiated damages awards totaling $214 million, with awards of attorneys' fees totaling $70 million.[246] Since

242. *Id.* at 1827.

243. *Id.*

244. *Id.* at 1826.

245. *Id.* at 1828–29 (citations omitted).

246. *See* Sara Randazzo, *Plaintiffs' Lawyer Takes on Retirement Plans*, WALL STREET J.: L. BLOG (Aug. 25, 2015, 1:39 PM), http://blogs.wsj.com/law/2015/08/25/plaintiffs-lawyer-takes-on-retirement-

then, new cases alleging millions in damages against ERISA plan fiduciaries have been filed against very large companies such as Chevron, Oracle, Anthem, Reliance Trust, and BB&T.[247] These lawsuits have rocked the world of employer-sponsored 401(k) plans and professional investment advisors.

Tibble obviously provides a powerful financial incentive for employers to outsource fiduciary decisions involving both the initial selection and ongoing monitoring of the menu of funds offered as investment options to participants in self-directed 401(k) plans.[248] There are three ways under ERISA's existing outsourcing rules that an employer who sponsors a 401(k) plan can obtain expert assistance with the management of the plan's assets.[249] The employer may design the plan so that a discretionary trustee manages the plan's assets, or the employer may use the plan document to delegate investment management authority to a third-party professional fiduciary by designating the outside professional as a section 3(38) investment manager in the written plan document.[250] Under this approach, the plan's named fiduciary (either the corporate employer or an internal committee composed of company employees) would retain an ongoing fiduciary duty periodically to review the investment manager's overall performance arising from the duty to monitor,[251] but would not be responsible for directly monitoring the plan's investments (or, in a participant-directed individual account plan, the menu of investment options).[252] Alternatively, the employer as the plan's named fiduciary may engage a section 3(21)(A) investment advisor as a co-fiduciary to assist the named fiduciary (again, generally an internal committee of officers and employees) with directly monitoring the plan's investment options and making decisions about whether to retain or replace the investments offered by the plan.[253]

plans/ (describing settlements in excessive fee cases paid to the St. Louis law firm of Schlichter Bogard & Denton LLP).

247. *See, e.g.*, Thomas E. Clark, Jr., *Oracle Sued by Schlichter Bogard & Denton After Recent Cases Against Anthem, Reliance Trust, and BB&T*, FIDUCIARY MATTERS BLOG (Jan. 26, 2016), http://blog.fraplantools.com/oracle-sued-by-schlichter-bogard-denton-recent-cases-against-anthem-reliance-trust-bbt (discussing cases against Oracle, Anthem, Reliance Trust, and BB&T); Jacklyn Wille, *Chevron Hit with Lawsuit over 401(k) Plan Fees*, BLOOMBERG BNA (Feb. 19, 2016), http://www.bna.com/chevron-hit-lawsuit-n57982067509 (discussing suits against Chevron and Anthem).

248. In a participant-directed 401(k) plan, the EBSA's long-standing enforcement position has been that the selection of the plan's menu of investment options is a fiduciary act. *See* Tibble v. Edison Int'l, 729 F.3d 1110, 1121–25 (9th Cir. 2013), *vacated*, 135 S. Ct. 1823 (2015). If the plan satisfies the criteria of ERISA section 404(c), then the plan fiduciaries are not responsible for losses caused by a plan participant's investment decisions. *See* 29 U.S.C. § 1104(c) (2012); 29 C.F.R. §§ 2550.404c–1, 2550.404c–5 (2015).

249. *See* 29 C.F.R. § 2509.75–8 (citing to question FR–15).

250. *See* 29 U.S.C. § 1103(a) (naming a trustee); *id.* § 1102(c)(3) (appointing an investment manager).

251. *See supra* notes 100–01 and accompanying text.

252. *See* Tibble v. Edison Int'l, 135 S. Ct. 1823, 1828–29 (2015).

253. *See supra* notes 64–68 and accompanying text.

If the employer designates a third party to serve as the plan's section 402(a) named fiduciary, the named fiduciary would have the employer's responsibilities as described above. The employer would not perform these fiduciary duties, but would be subject to ERISA's fiduciary standards in selecting, monitoring, periodically reviewing the performance of, and deciding whether to retain, the third-party named fiduciary.

After *Tibble*, what constitutes a "prudent" monitoring process for a plan's menu of investment options or for monitoring another fiduciary's decisions and related performance of fiduciary functions is unclear. Although the Supreme Court in *Tibble* failed to address this important practical question, the EBSA has published online materials for plan fiduciaries on topics such as monitoring plan fees and expenses, selecting plan service providers, and selecting target retirement date mutual funds as plan investment options.[254] These materials (which obviously lack the authority of formal administrative rule-making) consist of a series of high-level brochures that address basic practical questions, urging employers to

> be prepared to monitor the level and quality of the services and performance of investments to make sure they continue to be reasonable and they suit the needs of your employees. Make sure that you receive information on a regular basis so that you can monitor investment returns and service provider performance and, if necessary, make changes. Review any notices received from the service provider about possible changes to their compensation and the other information they provided when hired (or when the contract or arrangement was renewed).[255]

The EBSA materials do not dictate that employers must select the lowest-cost investment options or the cheapest investment manager. Rather, the EBSA encourages plan fiduciaries to consider the totality of the services provided when selecting plan investments and plan service providers.[256]

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254. *See Retirement Plans*, EMP. BENEFITS SECURITY ADMIN., https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/retirement (last visited Oct. 25, 2016) (expand all).

255. EMP. BENEFITS SEC. ADMIN., UNDERSTANDING RETIREMENT PLAN FEES AND EXPENSES 11 (2011), www.dol.gov/ebsa/publications/undrstndgrtrmnt.html.

256. EMP. BENEFITS SEC. ADMIN., MEETING YOUR FIDUCIARY RESPONSIBILITIES 5–6 (2012), http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html. ("Fees are just one of several factors fiduciaries need to consider in deciding on service providers and plan investments. When the fees for services are paid out of plan assets, fiduciaries will want to understand the fees and expenses charged and the services provided. While the law does not specify a permissible level of fees, it does require that fees charged to a plan be 'reasonable.' After careful evaluation during the initial selection, the plan's fees and expenses should be monitored to determine whether they continue to be reasonable. . . . Some service providers may receive additional fees from investment vehicles, such as mutual funds, that may be offered under an employer's plan. For example, mutual funds often charge fees to pay brokers and other salespersons for promoting the fund and providing other services. There also may be sales and other related charges for

Challenges to the prudence of the decision-making process can arise because fees and expenses become intertwined with plan investments. This occurs because other needed plan services, such as administration and recordkeeping, are often "bundled" together with the selection of higher-fee mutual funds offered by the service provider. The service provider may receive a portion of the fees generated by the mutual funds (known as "revenue sharing"), which can offset the cost of plan administrative services.[257] Although revenue sharing is permissible and the amounts must be disclosed (either as a dollar amount or as a formula), such bundling can make an "apples-to-apples" comparison among competing service providers difficult.[258]

If the fees for plan services are paid out of plan assets (thereby reducing the investment returns for participant accounts), then the fees must be "reasonable."[259] Reasonableness, however, varies with the circumstances, which includes the asset size of the plan. Although data on average costs according to plan size is readily available from industry sources,[260] the EBSA compliance materials do not require employers to consult with objective sources to ascertain the "reasonableness" of plan fees and expenses. Instead, employers typically solicit proposals from vendors (known as a "request for proposals" or "RFP"), compare the offers, and select one. Over time, however, the assets in the plan usually increase. This increase could enable the plan participants to qualify for lower-fee, institutional-class mutual funds from another service provider (the situation in *Tibble*), and could enable the plan to attract more competitive offers on the pricing of plan administrative services. Unfortunately, there is no definitive regulatory guidance determining the point at which the employer must conduct a new RFP process to determine if the current service provider's package of investments and services, along with related fees and expenses, are still reasonable.[261]

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investments offered by a service provider. The information provided by service providers noted above should include a description of all compensation related to the services to be provided that the service providers expect to receive directly from the plan as well as the compensation they expect to receive from other sources.").

257. *See id.* at 5.

258. *See id.* ("In comparing estimates from prospective service providers, ask which services are covered for the estimated fees and which are not. Some providers offer a number of services for one fee, sometimes referred to as a 'bundled' services arrangement. Others charge separately for individual services. Compare all services to be provided with the total cost for each provider. Consider whether the estimate includes services you did not specify or want. Remember, all services have costs.").

259. *See* 29 C.F.R. § 2550.408c–2 (2015) (requirements for prohibited transaction exemption for payment for services using plan assets).

260. *See generally* 401(K) AVERAGES BOOK (David W. Huntley & Joseph W. Valletta eds., 16th ed. 2016).

261. Industry experts generally recommend that an RFP process be conducted every three to five years. *See* Downie, *supra* note 164.

By this point, it should be apparent that additional regulatory guidance would be useful.[262] In practice, the exact requirements for acting loyally and prudently under section 404(a)(1) in selecting and periodically reviewing the performance of an outside professional fiduciary are unclear. How much and what types of due diligence are required—and should that level of due diligence vary with different types of outsourced fiduciary functions? How much detail must the plan's procedure provide? The EBSA on-line materials indicate that the scope of fiduciary services should be clearly defined at the outset, a task more easily described in the abstract than implemented. To illustrate, one industry-oriented article suggests that a section 3(16) plan administrator could perform as few as seven to eight functions or more than twenty functions as a fiduciary for the plan.[263] What contractual terms are necessary in structuring an outsourcing agreement to satisfy the named fiduciary's duties under section 404(a)(1)? Are there contractual terms that are illegal under ERISA, such as contractual risk-allocation terms that are de facto exculpatory clauses under section 410(a)? These are just a few of the practical questions that employers face when entering into a 405(c) fiduciary services agreement for a section 3(16) plan administration, a section 3(38) investment manager, a section 403 trustee, a section 3(21)(A) co-fiduciary investment advisor, or a section 402(a) named fiduciary.

Another area of ambiguity is the extent to which a named fiduciary oversight function under section 405(a) becomes a primary fiduciary duty under section 404(a)(1). To illustrate, assume that the employer acts as the plan's named fiduciary and outsources a fiduciary function under the written terms of the plan document to an outside professional fiduciary. Under what circumstances could the employer inadvertently "take back" the primary fiduciary responsibility for the outsourced fiduciary function? For example, assume that the section 405(c) fiduciary services agreement gives the employer the authority to "review and approve" or "review and reverse" a decision or action by the outside fiduciary? Does the employer become liable as a primary fiduciary under section 404(a)(1) for the outsourced fiduciary function—or perhaps liable as a co-fiduciary under a constructive knowledge interpretation of section 405(a)? What types of performance review and termination provisions must be in the agreement with the outsourced

262. The Advisory Council Report, which predates the Supreme Court's 2015 decision in *Tibble v. Edison International*, 135 S. Ct. 1823 (2015), lists recommended areas for additional guidance that do not involve the direct monitoring of investment options. The Advisory Council's first three priorities are: (1) to educate plan sponsors on current outsourcing practices in the professional fiduciary services industry; (2) to clarify the legal framework under ERISA for delegating fiduciary responsibilities to professional fiduciaries; and (3) to provide additional guidance on the duty to select and monitor professional fiduciaries and other service providers. ADVISORY COUNCIL REPORT, *supra* note 2, at 2.

263. *See* Darla Mercado, *New Flavor of Outsourced Fiduciary for Retirement Plans Hits the Market*, INVESTMENTNEWS (Apr. 2, 2014, 11:54 AM), http://www.investmentnews.com/article/20140402/FREE/140409982/new-flavor-of-outsourced-fiduciary-for-retirement-plans-hits-the.

fiduciary? The answers to these questions factor into the pricing for the outsourced fiduciary services, and raise additional questions about contractually allocating fiduciary liability risk in the outsourcing arrangement.

The scope of the duty to monitor a co-fiduciary who has been delegated fiduciary responsibilities necessarily impacts the pricing for section 405(c) fiduciary service agreements because co-fiduciary liability under section 405(a) is joint and several.[264] Second, even if the provision were not void under section 410(a), federal courts currently are divided on whether a contribution or indemnification claim may even be brought under ERISA section 502(a)(3) at all as a claim for "equitable relief."[265] Due to the fact that state-law based contract claims are preempted by ERISA,[266] is a federal civil claim under section 502(a)(3) the only effective enforcement mechanism for a contractual indemnification or contribution provision in a 405(c) fiduciary services agreement?[267]

These are just a few examples of ambiguities in the current law that impact the market for the pricing and variety of available professional fiduciary services.[268] Specific regulatory techniques could resolve some of these ambiguities and permit the market to perform more efficiently and more effectively.

B. Areas for Additional Regulation

New regulations from the EBSA could clarify four important areas where additional guidance is needed for both employers and the professional fiduciary services industry. Although the Advisory Council Report identifies these areas as ripe for additional regulatory guidance,[269] it does not attempt to describe specific regulatory techniques that might be effective, or suggest specific solutions to the problems presented by these areas of ambiguity. This Article proposes specific regulatory techniques, depending on the nature of legal ambiguity and whether it arises primarily in a transactional or litigation context, or both.

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264. *See supra* text accompanying notes 139–45.

265. *See, e.g.*, Travelers Cas. & Sur. Co. of America v. IADA Servs., Inc., 497 F.3d 862, 867 (8th Cir. 2007) (holding there was no right of contribution under ERISA); Summers v. State St. Bank & Tr. Co., 453 F.3d 404, 413 (7th Cir. 2006) (noting circuit split); Smith v. Local 819 I.B.T. Pension Plan, 291 F.3d 236, 242 (2d Cir. 2002) (permitting equitable claim for contribution/indemnification under ERISA); Kim v. Fujikawa, 871 F.2d 1427, 1434 (9th Cir. 1989) (deciding not to permit an equitable claim for contribution/indemnification under ERISA).

266. *See* 29 U.S.C. § 1144(a) (2012).

267. *See* 29 U.S.C. § 1132(e)(1) (granting federal courts exclusive jurisdiction over ERISA section 502(a)(3) claims).

268. *See* ADVISORY COUNCIL REPORT, *supra* note 2, at 8–14.

269. *See id.* at 2–3 (detailing the suggestions the Advisory Council presented).

1. Complete Outsourcing as an Exculpatory Technique

Given that professional fiduciaries are currently advertising section 402(a) named fiduciary services in the marketplace, the EBSA should immediately issue regulations clarifying that complete outsourcing, while permitted, will not relieve the employer who sponsors the plan from its primary ERISA fiduciary duties under section 404(a), or from its co-fiduciary duties under section 405(a) with regard to the decisions and actions of the third party named fiduciary. ERISA's legislative history, statutory syntax, and long-standing EBSA and lower court interpretations of the statute support a regulatory policy against complete outsourcing purely as an exculpatory technique. Under this regulatory approach, employers who desire to enter into a complete-outsourcing arrangement for the purpose of obtaining greater efficiency and expertise in plan administration can do so—but they remain subject to the ERISA fiduciary duty prudently to select the outside named fiduciary and monitor the named fiduciary's performance.

2. Safe Harbor Monitoring Duties and the Procedures for Selecting Service Providers

Under current law, employer compliance with the duty to monitor outside professional fiduciaries, the duty to monitor a pension plan's investment options under *Tibble*, and the prudence of the procedures used to select outside professional fiduciaries are all based on a totality-of-the-facts-and-circumstances analysis. Although this analysis provides maximum flexibility in its application, the EBSA could help to establish a "best practices" industry standard for employers and professional fiduciaries by creating safe harbor criteria in these areas. If the employer satisfies the safe harbor criteria, then a rebuttable presumption would arise that its actions satisfied its fiduciary responsibilities under ERISA. Separate and unique safe harbors would be needed for five situations:

(1) the selection and monitoring of a section 402(a) named fiduciary;

(2) the selection and monitoring of a section 3(16) plan administrator;

(3) the selection and monitoring of a section 3(38) investment manager;

(4) the selection and monitoring of a section 403 discretionary trustee; and

(5) the selection and monitoring of plan investment options (including the selection, monitoring, and reasonableness of reliance on a section 3(21)(A) investment advisor).

Although the exact safe harbor criteria for each scenario described above will vary, some common points that could be standardized using a safe harbor regulatory approach are:

(1) the required frequency of the RFP-selection process;

(2) a standardized list of basic information to be required as part of the RFP proposal from each prospective fiduciary;

(3) the types of services offered and the price (whether bundled or unbundled);

(4) the procedures to use in monitoring the different types of fiduciary services; and

(5) the minimum required levels of fiduciary liability insurance (based on plan assets and the fiduciaries involved with plan assets).

For selecting and directly monitoring plan investment options, the safe harbor should establish a best practices standard for benchmarking investment options, and require that fees paid from plan assets must be within the range of fees for plans of similar asset size as determined by objective industry sources.[270] Under this safe harbor approach, the named fiduciary who authorizes a level of fees paid from plan assets that is above the industry range would have the burden of proving that the fees are reasonable based on unique circumstances of the plan that require an extraordinary level of service. For example, if a majority of the employer's workforce is composed of non-English speakers who speak multiple languages, a level of fees that exceeds the industry range could be justified if translation services are provided to the employees.

3. Model Language for Key Outsourcing Agreement Terms

Once the safe-harbor criteria for fiduciary services have been created, the EBSA can both reduce transaction costs and encourage the adoption of best practices for outsourcing fiduciary services by creating model language for key terms in the section 405(c) fiduciary services agreement. Each category of fiduciary services necessarily will have its own customized language for scope of the particular services provided, but common model terms could address topics such as:

(1) the scope of the fiduciary services to be rendered by each type of outsourced fiduciary, including a checklist of mandatory and optional additional services;

270. *See generally* 401(K) AVERAGES BOOK, *supra* note 260 (compiling data such as average total cost per participant, average investment expenses, and range of investment expenses for small to large plans according to plan asset size).

> (2) allocating fiduciary responsibilities, including a description of the respective fiduciary duties of the named fiduciary and the professional fiduciary;
>
> (3) the procedures for monitoring of the professional fiduciary by the named fiduciary, including the type and frequency of delivery of any documents or reports to be provided by the professional fiduciary to the named fiduciary as part of the monitoring process;
>
> (4) the ability (or not) of the named fiduciary to review decisions made by the professional fiduciary, and the named fiduciary's power (or not) to approve or disapprove such decisions;
>
> (5) the level of fiduciary insurance coverage required for the professional fiduciary to carry until the termination of the engagement with the named fiduciary;
>
> (6) the terms and conditions pursuant to which the named fiduciary can terminate the fiduciary services agreement, consistent with the named fiduciary's duty to monitor the professional fiduciary; and
>
> (7) the contribution and indemnification rights of the named fiduciary and the professional fiduciary that are enforceable and not rendered void by section 410(a).

When variations are possible for these common model agreement terms, the EBSA could prepare various standardized options that could be inserted into the model agreement.

4. Regulatory Guidance on Co-Fiduciary Liability Issues

The two critical areas where ERISA co-fiduciary liability is unclear are the level of knowledge (actual or constructive) required for co-fiduciary liability under section 405(a), and whether the federal courts should recognize contribution or indemnification claims among co-fiduciaries as "equitable relief" under section 502(a)(3). The EBSA should address both areas through the issuance of new regulations that interpret co-fiduciary responsibilities and related liabilities under section 405(a), and the named fiduciary's primary duty to monitor a co-fiduciary as part of the general duty of prudence under section 404(a)(1)(B). The forthcoming implementation of the fiduciary investment advisor regulations in 2018 heightens the need for more definitive regulatory guidance in this area.

The EBSA should interpret the statutory language to require actual knowledge to trigger co-fiduciary liability under subsections 405(a)(1) and (a)(3), which deal with participation in a co-fiduciary's breach of duty or the failure to take affirmative action to cure a co-fiduciary's breach of duty. For subsection 405(a)(2), the EBSA should interpret the statutory cross-reference to section 404 as incorporating by reference the duty to monitor the co-fiduciary under the general duty of prudence. The EBSA's interpretation should make clear that if a named fiduciary breaches the duty to monitor, and the failure to monitor enables the co-fiduciary to breach its own primary fiduciary duties under section 404(a), then the named fiduciary is jointly and severally liable as a co-fiduciary under section 405(a)(2). The EBSA regulations should prohibit implicit waivers, in the form of contribution and indemnification clauses, of the named fiduciary's duty to monitor the co-fiduciary.

As part of its administrative authority to enforce the statute, the EBSA should issue regulations on the validity of contribution and indemnification clauses in section 405 fiduciary-services agreements. The regulations should provide that, if the EBSA's model language is used to define contribution and indemnification rights of co-fiduciaries, then a claim to enforce these rights constitutes a claim for "equitable relief" under section 502(a)(3) that may be brought in the federal courts.

V. CONCLUSION

Due to the complexities of regulatory compliance, private employers have become increasingly interested in outsourcing the fiduciary functions associated with operating and administering their employee benefit plans. Outsourcing fiduciary functions to professional fiduciaries has many advantages for both employers and plan participants in terms of increased efficiency and expertise in plan administration. Using outside professional fiduciaries to perform key plan functions can reduce costs due to economies of scale and the use of advanced technology, and can provide access to specialized legal and compliance expertise. This Article urges the EBSA proactively to regulate the professional fiduciary services industry by declaring that, as a matter of regulatory policy pursuant to the agency's administrative authority to interpret the statute, complete outsourcing of the section 402(a) named fiduciary function does not immunize the employer who sponsors the plan from its ERISA fiduciary responsibilities, particularly the duty to monitor. At the same time, the EBSA should encourage the development of "best practices" for employers and the professional fiduciary-services industry through the issuance of regulatory safe harbors, model agreement language, and interpretive regulations regarding ERISA co-fiduciary responsibilities. Additional regulatory guidance for employers would promote ERISA's primary policy objective of protecting the rights of plan participants and safeguarding their plan benefits. At the same time, additional regulatory guidance would support ERISA's secondary cost-control policy objective by bringing certainty to, and thereby strengthening, the private market for professional fiduciary services. In short, all of the interested stakeholders in the professional fiduciary services industry—the employers who sponsor ERISA plans, the employees who participate in those plans, and the professional fiduciaries who service them—would benefit from more robust regulation of fiduciary outsourcing.