The Who, When
of Independent Fi

by | **Stephen Wilkes** and **John Sohn**

Employee benefit plan sponsors may need to hire an independent fiduciary in certain situations in order to avoid conflicts of interest and prohibited transactions under ERISA. What is an independent fiduciary, and when might a plan need one?

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Employee benefit plan fiduciaries have a duty of loyalty under the Employee Retirement Income Security Act (ERISA) that includes broad prohibitions against fiduciary self-dealing. From time to time, a plan may run into a proposed arrangement that raises conflict-of-interest concerns and may need to hire an independent fiduciary to alleviate those concerns.

In general, independent fiduciaries are needed when the plan sponsor may need to transfer plan decision making to an outside party to avoid being viewed as entering a conflicted, prohibited transaction under ERISA. This article will describe what an independent fiduciary is, the types of services it provides and examples of transactions where one may be needed. It will also discuss the Department of Labor's (DOL's) recently proposed changes to the regulations for prohibited transaction exemptions (PTEs), which may make using an independent fiduciary more attractive.

What Is an Independent Fiduciary?

Firms that serve as independent fiduciaries may vary in their service offerings, and different firm types may handle different kinds of plan sponsor conflicts as illustrated in the figure on page 36.

Typically, independent fiduciaries fall into the following categories.

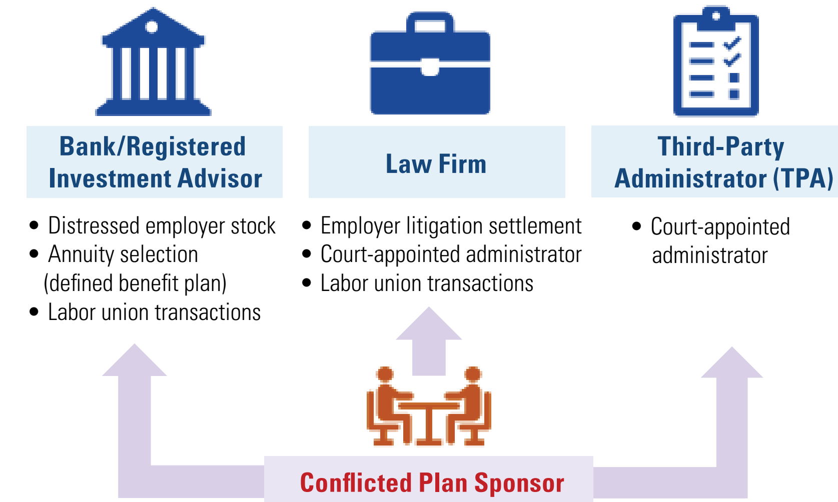
- Banks, trust companies and registered investment advisors (RIAs)
- Third-party administrators (TPAs)
- Law firms

When Are Independent Fiduciaries Needed?

As previously mentioned, a plan fiduciary might hire an independent fiduciary when it may be necessary to transfer plan decision making from the plan sponsor to an outside party to avoid being viewed as entering a conflicted, prohibited transaction under ERISA. These plan sponsor–level conflicts typically do not arise in the ordinary course of plan operations, and they are unlike the more common conflicts that are associated with external fiduciary advisors, such as an RIA or bank. (Sometimes, of course, a plan fiduciary may simply want to allocate a particularly complex decision to an independent third party with certain expertise.)

FIGURE

Types of Independent Fiduciary Service Providers



For example, a bank acting as an external fiduciary advisor to a plan may offer a new financial product that would generate additional revenue for the bank. This type of external fiduciary conflict generally may be mitigated when the proposed product or arrangement is independently evaluated and authorized by the plan sponsor.[1] The plan sponsor in this scenario would be acting as an unconflicted fiduciary, separately evaluating the prudence of the plan's investment in the bank product without any impermissible influence from the bank.

But what happens when the conflict involves the plan sponsor itself rather than an external fiduciary? For example, if plan participants file a lawsuit against the plan sponsor, the plan sponsor's decision to settle and release the plan's claims against itself could be viewed as a conflicted, prohibited transaction under ERISA. In these circumstances, it may be necessary to transfer the plan decision-making authority from the plan sponsor to an independent fiduciary to remediate the conflict.

Potential Conflicts of Interest for Plan Sponsors

ERISA retirement plans typically include single employer plans that are sponsored by individual employers and multiemployer retirement plans (also known as Taft-Hartley plans) that are typically sponsored and administered by a joint labor-management board of trustees. Potential conflicts of interest may arise for both types of plan sponsors as further discussed below.

Employer Litigation Settlements

One example of a conflict is a scenario where the plan holds or offers employer stock, and the employer seeks to settle a claim that it engaged in securities fraud, adversely impacting the value of the plan's holdings.

The employer is wearing two "hats" in this case—one as the defendant with the power to make a settlement offer to the plan and another as a plan representative with the power to accept such an offer. If the plan sponsor facilitates a settlement releasing the plan's claims against it, a self-dealing prohibited transaction may arise under ERISA.

To avoid this situation, the plan sponsor could appoint an independent fiduciary to either accept or decline the settlement offer on behalf of the plan. The appointment of an independent fiduciary is a key condition of PTE 2003-39, which is a class exemption that can provide formal relief for the plan's release of claims against the employer. Meeting its conditions is a "standard practice" in the case of plan-related settlements involving the plan sponsor.[2] Among other conditions, the independent fiduciary must not have a relationship or interest in any of the litigation parties, other than the plan, that might affect the exercise of its best judgment as a fiduciary.[3]

Distressed Employer Stock in DC Plans

In a similar example, if an employer's defined contribution (DC) plan offers plan participants the ability to invest in employer stock, special fiduciary concerns may arise if the employer becomes financially distressed. Specifically, the duties of prudence and diversification under ERISA may require the plan's governing fiduciaries to consider selling the employer stock for cash if there is a material risk that the stock may lose substantial value or become worthless. If the employer (i.e., plan sponsor) has the power to make that decision, significant conflict-of-interest concerns may arise. Those concerns are exacerbated if corporate insiders have access to material, nonpublic information that cannot be disclosed under applicable securities laws.

By transferring plan decision-making authority to a qualified independent fiduciary, the decision to retain or to sell employer stock can be made in an unbiased, prudent manner in compliance with ERISA. For example, in *Burke v. The Boeing Company*,[4] the U.S. Court of Appeals for the Seventh Circuit ruled that the employer and the plan's fiduciary committee could not be held liable for employer stock losses since oversight responsibilities for such plan investments were properly delegated to an independent fiduciary. In many instances, the engagement of an independent fiduciary will be the most practical approach for the plan sponsor to avoid controversy and minimize its risk from potential litigation involving the handling of employer stock. An independent fiduciary may be engaged when there are adverse changes in the employer's financial condition or, as illustrated in the *Boeing* case, as a preventive measure before any such changes occur.

Court-Appointed Fiduciary Administrators

If the DOL finds fiduciary misconduct in one of its investigations of a single employer, it may obtain a court order that removes the plan's governing fiduciaries (e.g., plan sponsor, management employees) and appoints an independent fiduciary in their stead. In many instances, this misconduct will occur when the employer is in extreme financial distress. Under these circumstances, it is not uncommon for the independent fiduciary to be charged with the responsibility of winding down the plan, distributing its assets to participants and terminating the plan. Furthermore, the independent fiduciary may perform nonfiduciary, administrative functions in addition to serving as a fiduciary administrator that is responsible for overseeing the final resolution of the plan.

Plan Transactions Involving Labor Unions

Collectively bargained plans may have to consider transactions from time to time that are expected to be beneficial to both the plan and its participating labor union. One example would be the sale of real property owned by the plan to the union. Because the board of trustees for a Taft-Hartley plan includes labor trustees (in addition to management trustees), a prohibited transaction may be triggered if the ultimate decision to approve and proceed with the prohibited transaction involves such trustees.

Another example would be the plan's leasing of office space—in a building owned by the plan—to a labor union whose members are plan participants. Any decision by the plan's trustees (including labor trustees) to authorize the lease for the union would potentially be conflicted, resulting in a prohibited transaction.

The DOL has issued two related class exemptions granting narrow relief for a multiemployer plan's leasing arrangement to a party in interest (e.g., labor union),[5] but there are no class exemptions that would cover a multiemployer plan's sale of real property to a union. The DOL has the administrative power to grant (and has granted) individual exemptions that provide broad relief for leasing arrangements[6] as well as those that cover real property transactions.[7]

As a condition of the individual exemptions, the terms of the proposed transaction generally must be at least as favorable to the plan as those available in an arm's length transaction. Moreover, such terms must be negotiated and approved by a "qualified independent fiduciary" as defined under the DOL regulations that govern the agency's procedures for filing PTE applications.

takeaways

- Independent fiduciaries are needed when a plan sponsor may need to transfer plan decision making to an outside party to avoid being viewed as entering a conflicted, prohibited transaction under the Employee Retirement Income Security Act.
- Firms that typically serve as independent fiduciaries fall into three categories: (1) banks, trust companies and registered investment advisors (RIAs); (2) third-party administrators (TPAs); and (3) law firms.
- Potential conflicts of interest that may require an independent fiduciary include settlements of employer litigation and the retention or sale of distressed employer stock in defined contribution plans.
- Independent fiduciaries also may be appointed by court order if the Department of Labor finds fiduciary misconduct by the plan's governing fiduciaries.
- Transactions involving collectively bargained plans and labor unions, such as the sale of real property owned by the plan to the union, may also require an independent fiduciary to avoid a prohibited transaction.

Under the current PTE procedures, a qualified independent fiduciary must be independent and unrelated to any party in interest engaging in the exemption transaction and its affiliates. The independent fiduciary must pass a quantitative revenue test (i.e., its revenue from such parties must be less than a stated percentage).[8]

Engaging Independent Fiduciaries Without Obtaining PTEs

When faced with conflicts, plan sponsors will often apply for and obtain an individual exemption in accordance with the DOL's PTE procedures. But the DOL's grant of a PTE in the past should not be viewed as conclusive evidence that the exempted transaction was, in fact, a prohibited transaction requiring exemptive relief.[9] Instead of obtaining an individual exemption, it may be reasonable to conclude that exemptive relief is not necessary and that the engagement of an independent fiduciary would be sufficient. Plans should consult ERISA counsel in making this assessment and adhere to other best practice conditions as necessary to ensure that a prohibited transaction is not being impermissibly triggered.

For example, assume that a Taft-Hartley plan is considering a proposed transaction that is similar in nature to transactions that were previously "blessed" by the DOL in various individual exemptions. The plan could, of course, proceed with the PTE application process. Alternatively, it may wish to consider hiring an independent fiduciary and following any other necessary practices that eliminate the need for formal exemptive relief.

This option may become more attractive in light of the DOL's proposed amendments to its PTE procedures. If adopted, these amendments would impose new technical requirements on exemption applicants and may make it significantly more difficult (and more costly) for applicants to obtain PTEs from the DOL. For example, under the proposed changes, all applicants and independent fiduciaries would need to comply with the impartial conduct standards of PTE 2020-02, a seemingly unrelated class exemption that requires conflicted investment advisors to act in the best interest of the plan. Any new regulatory burdens that arise will likely provide an added incentive for plan sponsors to explore compliance strategies that do not involve a formal PTE application.

The Need for Different Types of Independent Fiduciaries

Different types of conflicts require different kinds of independent fiduciaries with specialized expertise and capabilities. For example, law firms may be particularly well-suited to serve as independent fiduciaries when circumstances involve conflicts arising from complex or unusual facts and issues or complex alternative investment structures (where the law firm would also likely be assisted by a financial industry expert). Law firms are especially suited to speak to the independent fiduciary decision-making process as being reasonable and appropriate under the circumstances. TPAs may be the most efficient choice for handling matters that are expected to involve a high volume of administrative plan transactions. Banks and RIAs are the natural candidates for addressing conflicts that require an evaluation of a specific investment or an investment-related course of action.

The types of independent fiduciaries that may be appropriate for the plan sponsor conflicts discussed in this article can be categorized as follows.

- **Employer litigation settlement.** Law firms that are not otherwise involved in the proceedings may be well-positioned to remediate conflicts surrounding settlement offers.
- **Distressed employer stock in DC plans.** Banks, RIAs or law firms may have the specialized expertise required to address employer stock–related conflicts in DC plans. Similar issues in DB plans may also be appropriate for these independent fiduciaries.
- **Court-appointed fiduciary administrators.** TPAs or law firms may be qualified to replace a plan's governing fiduciaries in cases where the court has ordered their removal.
- **Transactions involving labor unions.** Banks, RIAs or law firms may be able to serve as independent fiducia-

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ries for plans that have obtained corresponding PTEs from the DOL (or that have prudently decided to forgo the PTE application process).

The determination of whether a specific firm is suitable for addressing a specific conflict involves a highly fact-intensive inquiry. For example, plan sponsors may consider the firm's relevant experience with plans, its knowledge of ERISA and fiduciary requirements, the applicable qualifications of the firm's personnel, the reasonableness of fees in light of services, fiduciary liability insurance coverage and the adequacy of the firm's information systems and security safeguards.

Conclusions

When plan sponsors face conflict-laden decisions that are material to their plans, it may be necessary to transfer decision-making authority to an independent fiduciary. Plan sponsors may apply for exemptive relief from the DOL in accordance with its PTE procedures, but they may also wish to consider the feasibility of relying on an independent fiduciary without applying for an individual exemption. Different types of conflicts require different kinds of independent fiduciaries, and plan sponsors should carefully consider a firm's qualifications and expertise when selecting an appropriate independent fiduciary.

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Stephen Wilkes is a partner and chief legal officer at The Wagner Law Group, a national Employee Retirement Income Security Act (ERISA) and employee benefits law firm, where he leads both the ERISA fiduciary investment practice group and the ERISA independent fiduciary practice group. He is experienced in all aspects of ERISA and employee benefits and has particular expertise with the legal and practical challenges arising from the delivery of investment products and services by the financial services industry across the retirement plan sector. As legal counsel or an independent fiduciary, Wilkes regularly addresses a variety of plan issues related to ERISA, the Internal Revenue Code and related banking, health care, labor, bankruptcy, corporate and securities laws. He holds J.D. and M.B.A. degrees from Emory University in Atlanta and is a frequent speaker on ERISA and related topics.

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Endnotes

1. Section 3(16)(B) of the Employee Retirement Income Security Act (ERISA) defines the *plan sponsor* as the employer, employee organization or joint board of trustees, as applicable, that has established or maintains the plan. Typically, the plan sponsor is also designated as a "named fiduciary" with the authority to control and manage the operation and administration of the plan under ERISA Section 402. For purposes of this article, we have assumed that the plan sponsor is also a named fiduciary.
2. PTE 2003-39 provides exemptive relief for prohibited transactions under ERISA Section 406(a) that involve the plan and a "party in interest" such as the employer. The PTE does not provide relief for fiduciary self-dealing under ERISA Section 406(b), and such relief generally would not be necessary to the extent that the decision-making authority resides with an independent fiduciary.
3. PTCE 2003-39, Section II(b).
4. No. 20-3389 (7th Cir. Aug. 1, 2022).
5. PTE 76-1 and PTE 77-10 are class exemptions providing narrow relief for party-in-interest transactions and a labor trustee's ERISA 406(b)(2) conflict for acting on both sides of the leasing arrangement (plan and union), respectively, but no relief is provided for the labor trustee's ERISA 406(b)(1) conflict for dealing with the plan in their own interest.
6. In response to applicants' requests, the Department of Labor (DOL) has granted individual exemptions for leasing arrangements involving labor trustee conflicts, where broad relief is provided for both ERISA 406(b)(1) and (b)(2) conflicts.
7. See, e.g., PTE 2015-01, PTE 2018-04.
8. The DOL published proposed amendments to its PTE Procedures on March 15, 2022, imposing new requirements on exemption applicants and toughening the requirements for qualified independent fiduciaries.
9. For example, the DOL has stated that "the fact that a transaction is subject to an administrative exemption is not dispositive of whether the transaction is, in fact, a prohibited transaction." Section I.A of the preamble to PTE 2003-39.

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