A Current Look at Independent Fiduciaries under ERISA

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Under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), certain financial and other transactions involving retirement and other employee benefit plans governed by ERISA warrant the appointment of an independent fiduciary to avoid or mitigate conflicts of interest. Some transactions require the participation of an independent fiduciary to avoid the transaction being prohibited. Other transactions may benefit from the use of an independent fiduciary to prevent conflicts of interest that could otherwise occur based on relationships of the regular plan fiduciaries. Or, more simply, an independent fiduciary in some cases may add a level of independent review and protection for plan participants and beneficiaries.

While "independent fiduciary" is not a defined term under either ERISA or the corresponding provisions of the Internal Revenue Code of 1986, as amended (the "Code"), it has long been clearly defined in statutory and prohibited transaction exemptions issued by the Department of Labor (the "Department"). In fact, many class exemptions and individual exemptions require the services of independent fiduciaries as a condition of compliance. More recently, the prohibited transaction exemption regulations specifically define the term "qualified independent fiduciary" for purposes of the procedures for obtaining individual or class prohibited transaction exemptions.

By way of background, while the concept of an independent fiduciary with respect to employee benefit plans predates ERISA, it was not frequently utilized, and the terminology was different. A good pre-ERISA illustration involved a case in which the United States District Court, District of Columbia, found that conflicts of interest and fiduciary breaches in the operation and administration of a multiemployer welfare plan called for the replacement of the existing trustees and the appointment of a new neutral trustee subject to the approval of the Court. The Court also required the services of an independent professional to develop an investment policy regarding the investment of plan assets. In later years, post-ERISA enactment, the pension community witnessed the more evolved use of an independent fiduciary – for example, for settlement purposes, sometimes accompanied by the appointment of an independent investment manager or independent special counsel as well.

Independent fiduciaries often play a critical role in satisfying the conditions of prohibited transaction exemptions including statutory, class and individual exemptions.[1] Several statutory exemptions under

ERISA specifically require that the plan's decisionmaker be independent. Examples include Sections 408(b)(14) and 408(g)[2] with respect to participant investment advice; Section 408(b)(16) with respect to alternative trading systems; Section 408(b)(19) with respect to cross-trading; Section 408(b)(4) with respect to bank deposits; and Section 408(b)(8) with respect to common or collective trust funds. In addition, two statutory exemptions (discussed below) expressly require the appointment of an independent fiduciary to satisfy the statutory conditions.

Additionally, litigation settlements may require or benefit from having an independent fiduciary approve the settlement. Court-approved settlements in some excessive fee cases involving 401(k) plans have required the appointment of an independent fiduciary to monitor the fund selection and review process. In any event, the appointment of an independent fiduciary to advise or act with discretion on any matter provides not only the benefit of an independent and qualified party to act on behalf of the plan participants but presents significant risk shifting opportunity from the plan fiduciary to the independent fiduciary.

WHAT IS AN "INDEPENDENT FIDUCIARY"?

In October 2011, the Department amended the procedures for applying for individual and class prohibited transaction exemptions by, among other things, adding a definition of qualified independent fiduciary.

According to the Department, the purpose of including this definition in the prohibited transaction exemption application procedures was "to emphasize that any independent fiduciary or appraiser[3] retained in connection with an exemption transaction must not only be 'qualified' (i.e., knowledgeable as to its duties and responsibilities under ERISA and knowledgeable as to the subject transaction and the markets, if any, where such transactions normally occur) to serve in that capacity, but also must be free from certain relationships with the party in interest (or its affiliates) that could improperly affect its judgment."[4] These procedures were again amended in 2024, and the Department's most recent regulation defines a "qualified independent fiduciary" as follows:

> A *qualified independent fiduciary* is any individual or entity with appropriate training, experience, and facilities to act on behalf of the plan regarding the exemption transaction in accordance with the fiduciary duties and responsibilities prescribed by ERISA, that is independent of and unrelated to any party in interest engaging in the exemption transaction (and its affiliates). In general, the Department will make the

> determination of whether a fiduciary is independent based on all relevant facts and circumstances, such as the extent to which the plan's counterparty in the transaction participated in or influenced the selection of the fiduciary. In making this determination, the Department will also take into account, among other things, the amount of both the fiduciary's revenues and projected revenues for the current Federal income tax year (including amounts received for preparing fiduciary reports) that will be derived from parties in interest engaging in the exemption transaction (and their affiliates) relative to the fiduciary's revenues from all sources for the prior Federal income tax year.[5]

The regulation also makes it clear that a qualified independent fiduciary must not have a financial relationship with the transaction or its parties, including from the fees the independent fiduciary is receiving for its duties, that would impair its independence. The regulation goes on to say that:

> The Department generally will not conclude that a fiduciary's independence is compromised solely based on the revenues it receives from parties in interest (and their affiliates) that engaged in the exemption transaction, to the extent that the fiduciary neither receives nor is projected to receive more than two (2) percent of its revenues within the current Federal income tax year from the parties in interest (and their affiliates). Although larger percentages merit more stringent scrutiny, a fiduciary may be considered independent based upon other facts and circumstances provided that the fiduciary neither receives nor is projected to receive more than five (5) percent of its revenues within the current Federal income tax year from the parties in interest (and their affiliates) that engaged in the exemption transaction.[6]

Thus, one important element of the deciding fiduciary's independence is whether it is paid so much by the plan's regular fiduciaries that the payments themselves – including the payments for the independent fiduciary services – have the potential to distort the judgment of the supposedly independent fiduciary.

As discussed below, the regulations place the burden on the applicant for a prohibited transaction exemption to demonstrate the independence of the fiduciary.[7]

In the event that a qualified independent fiduciary is required to be retained with respect to a particular transaction, the application for an individual exemption authorization must, among other things, include the following information from the fiduciary:

- A description of the fiduciary's qualifications to serve as a qualified independent fiduciary as well as a description of its prior experience in serving as an independent fiduciary to an ERISA plan;

- A description of any relationship the fiduciary has had or may have with a party in interest engaging in the transaction with the plan, or its affiliates;

- An acknowledgement by the fiduciary that it understands its duties under ERISA; that it is acting as a fiduciary of the plan with respect to the transaction; that it has no material conflicts of interest and that it is not acting as an agent of the plan sponsor; and

- The opinion of the qualified independent fiduciary whether the transaction would be in the interest of the plan and its participants and beneficiaries; protective of the rights of participants and beneficiaries and a statement of the reasons on which the opinion is based.[8]

Additionally, the application for an individual prohibited transaction exemption must indicate the names of the persons who will bear the cost of the fees payable to such fiduciary.[9]

An independent fiduciary may also be needed when a conflicted trustee will receive additional compensation pursuant to the transaction. In this situation, the Department regulations emphasize the importance of independence of the appointing fiduciary in addition to the independence of the independent fiduciary itself.[10] While there generally is no Section 406(b)(1) violation where one fiduciary is retained by a second fiduciary on behalf of a plan to provide a service for an additional fee, the Department added a cautionary note: "However, because the authority, control, or responsibility which makes a person a fiduciary may be exercised 'in effect' as well as in form, mere approval by a second fiduciary does not mean that the first fiduciary has not used any of the authority, control, or responsibility which makes such person a fiduciary to cause the plan to pay the first fiduciary an additional fee for the service." Therefore, it is important to make sure that any fiduciary appointing the independent fiduciary does not itself have a conflict of interest that would call the validity of the appointment into question or compromise the independence of the independent fiduciary.

In other contexts involving PTCEs, while the term "independent fiduciary" is not used, it may be clear from the structure of the PTCE that fiduciary independence is a prerequisite. The PTCE for qualified plan asset managers ("QPAMs")[11] is a clear illustration of this approach. As the Department stated, "PTE 84-14 was developed and granted based on the essential premise that broad relief could be afforded for all types of transactions in which a plan engages only if the commitments and the investments of plan assets and the negotiations leading thereto are the sole responsibility of an independent, discretionary, manager."[12] To qualify under the QPAM exemption, the transaction must not be entered into with a party in interest with respect to a plan if the assets of the plan in question, when combined with the assets of all other plans of the same employer and its affiliates (or union in the case of a multiemployer plan) represent more than 20% of the total client assets managed by the QPAM at the time of the transaction.[13] This limitation would seem to ensure that a QPAM is not so beholden to the plan that it manages that it lacks independence.

See also PTCE 2003-39, dealing with the release by a plan or plan fiduciary of the plan or participants' claim against a party in interest in exchange for consideration. One of the conditions for this exemption is that the fiduciary that authorizes the settlement "has no relationship to or interest in, any of the parties involved in the litigation, other than the plan, which might affect the exercise of such person's best judgment as a fiduciary." Further, see PTCE 2020-02, § V(f), explaining when a fiduciary may be treated as independent of a financial institution or investment professional.

Examples of other prohibited transactions that require an independent fiduciary or some variation of an independent party are PTCE 77-4 (mutual funds); PTCE 77-9 (insurance contracts); PTCE 86-128 (securities transactions); PTCE 85-68 (purchase of customer notes); PTCE 96-62 (EXPRO); and 96-23 (In House Asset Manager, or INHAM).

STATUTORY PROHIBITED TRANSACTION EXEMPTIONS REQUIRING INDEPENDENT FIDUCIARIES

As noted above, there are some specific statutory PTEs that require the use of an independent fiduciary.

- *Provision of Pharmacy Benefit Services:* When it was enacted, Division P of the Further Consolidated Appropriations Act of 2020, Section 1302, did not seem to receive much attention from ERISA practitioners even though it added a new statutory prohibited transaction exemption, Section 408(h),[14] with respect to the provision of pharmacy benefit services. This temporary exemption was directed at a particular set of union plans that were using a pharmacy benefit manager created by the union. Among the conditions of the statutory exemption was the retention by a group health plan subject to the exemption of an independent fiduciary who would have responsibility both for monitoring compliance with other conditions of the exemption and for making decisions regarding the provision of pharmacy benefit services.[15]

- *Transactions Executed Through an Electronic Communication Network:* Section 408(b)(16) exempts from ERISA's prohibited transaction provisions a transaction involving the purchase or sale of securities or other property between a plan and a party in interest executed through a regulated "electronic communication network, alternative trading system, or similar execution system or trading venue" if certain conditions are met. Where the party in interest has an ownership in the system or venue, authorization by an independent fiduciary is required by the statute in order to permit parties to take advantage of the exemption.[16]

HOW IS INDEPENDENCE DEFINED?

We can get some guidance as to the meaning of "independence" from Section 3(18), which defines "adequate consideration," and its guidance. In the proposed regulations defining that term, the Department proposed that a good-faith determination of fair market value must be made by a fiduciary who is in fact independent of all parties to the transaction (other than the plan). In this regard, the assessment is made in light of all of the relevant facts and circumstances. However, a person is not to be considered independent of all persons to a transaction (other than the plan) if that person (i) is directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with any of the parties to the transaction (other than the plan); (ii) is an officer, director, partner, employee, employer or relative (as defined in Section 3(15), but also including siblings) of any such party (other than the plan); or (iii) is a corporation or partnership of which any such party (other than the plan) is an officer, director or partner

Plan fiduciaries are not expressly bound by the Department's strict definition of independence in situations in which the definition does not apply. For example, in explaining why the reasonable compensation statutory exemption for service providers does not apply to fiduciaries, the Department stated: "These [Section 406(b)] prohibitions are imposed upon fiduciaries to deter them from exercising the authority, control, or responsibility which makes such persons fiduciaries when they have interests which may conflict with the interests of the plan for which they act. In such cases, the fiduciaries have interests in the transactions which may affect the exercise of their best judgment as fiduciaries."[17] We suggest here that a key word – if not the key word in this context – is *may*.

Not all conflicts of interest require the appointment of an independent fiduciary, even if they represent a significant percentage of litigated conflict of interest cases. For example, in the context of a self-insured welfare plan, or an insured plan in which the insurer both evaluates claims and pays benefits, there is a conflict of interest because the same entity both evaluates and pays benefit claims from its own funds.[18] Independent fiduciaries are not hired in these situations because the expense of hiring them would in many instances not be justified, and because a participant's entitlement to benefits will be determined as a matter of law under the plan document. Also, the Department's claims regulation inserts some level of independence into the claim process by, for example, requiring that the individual reviewing an appeal not be either the same individual who decided the original claim or a superior of that person.[19] Thus, in those cases, it is far less likely that the potential conflict of interest that remains after the protections of the claim regulation are followed is relevant to the interests of the participants and beneficiaries. Particularly in a large plan, the size of any particular claim compared to the plan sponsor's general assets makes it highly unlikely that the theoretical conflict would impact the applicable fiduciary's decision-making processes.

Also, ERISA's overall structure contemplates that employers will often have a dual role, in that they are the plan sponsors with an array of settlor functions but they also have administrative responsibilities for the plan, many of which rise to the level of fiduciary responsibilities. Clearly, in drafting ERISA, Congress did not intend to erase every conceivable conflict of interest.

In situations where an independent fiduciary is warranted, it is important as a contractual matter that the precise scope of the independent fiduciary's responsibilities be set forth. For example, is the independent fiduciary's role to be an advisor to the plan's fiduciaries,[20] or is it to be the independent decision maker? If it will be acting as a Section 3(38) investment manager[21] or as a QPAM, it will be acting as a discretionary decision maker, and if it is a Section 3(38) investment manager, the relevant plan fiduciary that appointed the independent fiduciary will have the duty to monitor its performance. Other considerations could include whether and to what extent the independent fiduciary may employ other professional advisers to assist it in performing its role (and who has the responsibility for those expenses); whether the independent fiduciary will provide any form of reporting; and the nature of any indemnity being provided to the independent fiduciary and which party will be providing it.[22] Once these structural questions are answered, then appropriate decisions can be made as to the level of independence required and as to what protections should be included in the contract to protect the independence of the independent fiduciary.

POTENTIAL CONFLICT SITUATIONS

A particular type of conflict situation arises in the context of employer stock in qualified plans. Employers have long been offering employee ownership in their companies by providing company stock as an investment option in their defined contribution plans, including employer 401(k) plans and employee stock ownership plans ("ESOPs"). Company stock in a retirement plan can be a significant source of fiduciary risk and has been the basis for many lawsuits brought against defined contribution plan sponsors. Participant portfolios overly concentrated in company stock are subject to significant losses if the value of the company stock declines rapidly.[23] Inversely, participants have sued because the employer stock rose in value after it was removed from the plan.[24] Courts have held, in the ESOP context, that fiduciaries who delegated investment decisions to an independent fiduciary were protected from liability for the plan's continued offering of company stock, even when the stock's value dropped significantly.[25]

Addressing potential conflicts of interest in certain scenarios can be challenging when corporate insiders possess significant nonpublic information, but securities laws limit their ability to disclose or act on that information. In these scenarios an independent fiduciary may be required, particularly for a company that is publicly held, where stock of that company is held in a defined benefit plan's portfolio and the named fiduciary of the plan is a committee consisting of executives of the plan sponsor, or company stock is one of the options offered in an individual account plan. [26]

Another common scenario is a tender offer in which the plan of the target company owns company stock. Officers of the target company interested in retaining their jobs may wish to fend off the tender offer to retain their positions, even if such action might not be in the best interest of plan participants and beneficiaries.[27]

Due to the substantial funds involved in ERISA-covered health plans and the general lack of transparency surrounding the costs of health services and pharmaceuticals (despite the recent statutory and regulatory provisions mandating transparency[28]) there have been recent cases focusing on fiduciary duties relating to excessive fees and how plans choose to provide pharmacy benefits to their employees and, in particular, their choice of a structure for their pharmacy benefit manager ("PBM") agreements[29] Although the law is still evolving through these cases, they show the value that an independent fiduciary with deep expertise in ERISA and PBMs can bring in appropriate scenarios[30] to the oversight of the selection and management of PBM programs.

Other situations where the services of an independent fiduciary might be required, due to potential conflicts of interest, include:

- In-Kind Contributions. Assessing whether an in-kind contribution to a tax-qualified plan, where it would not be a prohibited transaction, is in the best interest of participants and beneficiaries (i.e., whether the in-kind contribution is a better option than the receipt of cash).

- ESOP Transactions. Representing a plan during ESOP transactions.

- Terminating ESOPs. Acting on behalf of participants in a terminated ESOP for matters related to winding down the plan, including managing compensation matters and the distribution of sales proceeds.

- Class Action Lawsuits. Representing a plan involved in a class action lawsuit where the plan committee or sponsor is a party.

- Service Provider Selection. Assisting with the selection and retention of service providers for the plan.

- Annuity Purchases. Overseeing the purchase of annuities to ensure they align with the plan's interests.

- Alternative Investments. Determinations as to whether a plan should invest in alternative investments that may produce a higher return (where the alternative might be to increase contributions)

- Exemption Requests. Handling individual exemption requests for transactions between unions and pension or welfare funds when a prohibited transaction class exemption is not available.

- Plan Forfeitures. If a plan allows for discretion in the use of forfeitures, it's important to document the decision-making process associated with forfeitures and a fiduciary may consider bringing in an independent fiduciary to assess their use.

CONCLUSION

In the prohibited transaction context, a plan and its fiduciaries may have no choice but to retain an independent fiduciary, in which case no evaluation of the benefits and disadvantages of the hiring of an independent fiduciary is required. In cases where there is a risk, but not a certainty, of a prohibited transaction occurring, an independent fiduciary may be helpful to avoid or reduce such risk. In the private party conflict of interest situation, where there is no potential prohibited transaction, but a breach of the fiduciary duty of loyalty is possible, a conflicted party may wish to consider the benefits and disadvantages of hiring an independent fiduciary.

In the conflict of interest situation, even though hiring an independent fiduciary might be regarded a best practice, it often is not a per se requirement. There may be drawbacks to hiring an independent fiduciary. First, the same process for engaging any service provider to a plan, which is time-consuming and expensive, applies to the hiring of an independent fiduciary. This includes the drafting of a contract with the independent fiduciary (not likely to be an off-the-shelf document). Second, an independent fiduciary may reach a conclusion that the hiring fiduciary did not expect and does not desire. Third, on any occasion in which a new fiduciary is added to the list of parties administering the plan, the risk of co-fiduciary liability under Section 405(a) increases. Fourth, in the course of conducting their due diligence, the independent fiduciary might uncover other deficiencies in plan operation of which the hiring fiduciary was unaware (although from an overall plan perspective this may be an advantage). Fifth, to the extent the independent fiduciary has a monitoring role that is scheduled to persist for a period of years, operating a plan with an independent fiduciary monitoring those operations might affect the way in which a plan committee conducts its business. Sixth, if plan assets are paying the independent fiduciary's fee, the hiring fiduciary would need to justify the cost.

Against the possible negative outcomes and additional costs, however, the clear benefit of engaging a competent independent fiduciary focused solely on acting in the interest of plan participants and beneficiaries and thereby clearing the path forward for beneficial transactions and investments must be carefully weighed in the balance.

NOTES

1. The Secretary of Labor is authorized to grant class and individual exemptions from the prohibited transaction provisions found in ERISA as well as parallel prohibited transaction provisions found in the Internal Revenue Code and FERSA. See 29 U.S. Code § 1108; Secretary of Labor's Order 6-2009, 74 FR 21524 (May 7, 2009).
2. Unless the context otherwise requires, all section references herein are to sections of ERISA.
3. 76 Fed. Reg. 66638 (Oct. 27, 2011). In addition to adding a definition of qualified independent fiduciary to the regulations, the modification also added a definition of qualified independent appraiser.
4. *Id*. The same standard is set forth in 29 C.F.R. § 2550.408(b)(2)(e) – a fiduciary cannot use the authority, control, or responsibility that makes such person a fiduciary to cause a plan to pay an additional fee to a person "in which such fiduciary has an interest which may affect the fiduciary's best judgment as a fiduciary."
5. 89 Fed. Reg. 4662, 4692 (Jan. 24, 2024).
6. 29 C.F.R. § 2570.31(j).
7. 29 C.F.R. § 2570.34(f)
8. 29 C.F.R. §§ 2570.34(f)(4)-(7).
9. 29 C.F.R. § 2570.35(a)(19).
10. 29 C.F.R. § 2550.408b-2(e)(2).
11. 89 Fed. Reg. 23090 (Apr. 3, 2024).
12. 75 Fed. Reg. 38837 (July 6, 2010).
13. *Id*.
14. 29 U.S.C. § 1108(h).
15. 29 U.S.C. § 1108 (h)(2)(C), (D).
16. 29 U.S.C. § 1108(b)(16).
17. 29 C.F.R. § 2550.408b-2(e).
18. This issue was addressed by the Supreme Court in *Metro. Life Ins. Co. v. Glenn*, 554 U.S. 105, 128 S. Ct. 2343 (2008).
19. 29 C.F.R.§ 2560.503-1(h)(3)(ii).
20. Under Section 402(a)(2), if the plan so provides, a named fiduciary may employ other persons to render advice to the named fiduciary to assist the named fiduciary in carrying out his investment responsibilities under the plan. See 29 C.F.R. § 2509.75-8 (Q&A FR-15).
21. A 3(38) investment manager actually takes over the investment responsibilities for certain plan assets, rather than merely giving investment advice to the plan's regular fiduciaries.
22. In the preamble to the 2024 amendments to its prohibited transaction exemption application procedures, the Department expressed strong concerns regarding indemnity provisions: "When parties agree to relieve fiduciaries from accountability through releases, waivers, and indemnification or reimbursement agreements, they undermine the protective conditions of an applicable

exemption, compromise the independence of their services, and cast doubt on the reliability of the service providers' work." 89 Fed. Reg. 4662, 4676. Even so, the Department agreed with commenters that contractual reimbursement provisions may be appropriate under specific circumstances.

23. See e.g., *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014).
24. See e.g., *Tatum v. RJR Pension Inv. Comm*., 855 F.3d 553 (4th Cir. 2017).
25. See *Burke v. Boeing Co.*, 42 F.4th 716, 719 (7th Cir. 2022).
26. See e.g., *Tittle v. Enron Corp. (In re Enron Corp. Sec. Derivative & ERISA Litig.)*, 284 F.Supp.2d 511, n 66 (S.D. Tex. 2003) (discussing the duties of a fiduciary in possession of non-public information the disclosure of which may, or may not, violate insider trading rules).
27. See, e.g., *Donovan v. Bierwith*, 680 F. 2d 263 (2d Cir. 1982) in which the Court of Appeals for the Second Circuit addressed the existence of a conflict between the trustees and plan participants and beneficiaries in the tender offer situation. *Bierwith* was followed in *Leigh v. Engle*, 727 F. 2d. 113 (7th Cir. 1984), in which the Court of Appeals for the Seventh Circuit cited with approval the Department's position in an amicus brief that when a fiduciary finds himself or herself in a situation of a potential conflict of interest, where the risk is too great that the fiduciary will be unable to uphold his or her duty of loyalty, the fiduciary should resign and have an independent trustee appointed in his or her place to manage the assets of the plan.
28. See TD 9929, 85 FR 72158 for Transparency in Coverage Final Regulation. See Section 204 of Title II (Transparency) of Division BB of the Consolidated Appropriations Act, 2021. See Executive Order 14221, "Making America Healthy Again by Empowering Patients with Clear, Accurate, and Actionable Healthcare Pricing Information."
29. See e.g*.*, *Lewandowski v. Johnson & Johnson*, Civil Action No. 24-671 (ZNQ) (RLS), 2025 U.S. Dist. LEXIS 12732 (D.N.J. Jan. 24, 2025) and *Navarro v. Wells Fargo & Co*., No. 24-cv-3043 (LMP/DTS), 2025 U.S. Dist. LEXIS 53444 (D. Minn. Mar. 24, 2025).
30. Appropriate cases might include, for example, a medical provider encouraging or forcing its own employees to use its services, for which it is paid by the plan, such as a hospital system charging reduced copayments for use of its own facilities so as to incentivize participants and beneficiaries to utilize those facilities instead of alternative facilities.