

## Invest n Retire® Describes the Role of ERISA §3(38) Investment Managers

A Plan Sponsor (Plan Administrator) may hire a §3(38) Investment Manager who accepts the fiduciary responsibility (and therefore fiduciary legal liability) to:

1. Select the investment options for the plan
2. Construct model portfolios which may be offered to plan participants
3. Construct qualified default investment alternatives (QDIAs) which may be used as default investments for participants who fail to make an affirmative investment election
  - a. The 3(38) investment manager would need to construct the models in accordance with the Department of Labor (DOL) guidelines for such models
  - b. Determine the criteria the investment manager will use in constructing QDIA models and assigning the models to plan participants:
    - i. Age demographics for models based solely on participant age without taking into account any other demographics<sup>1</sup> (e.g. target-date models).
    - ii. Employee demographics for models based on a target level of risk appropriate for participants of the Plan as a whole (e.g. balanced model or conservative model). Demographics may include:
      1. Age
      2. Income
      3. Risk tolerance
      4. Other investments
4. Monitor the investment options and models and make any changes the investment manager deems necessary.
5. Provide the plan sponsor with an overview and documentation, at least annually, regarding the selection of the investment options offered to plan participants and management of the models so that the plan sponsor may fulfill its fiduciary responsibility (and therefore its legal liability) regarding the sponsor's engagement of the manager and continued engagement of the manager.

Plan sponsors may hire an ERISA 3(38) investment manager to accept the fiduciary responsibility (and legal liability) for the discretionary management of the investment options offered to plan participants. However, the plan sponsor can never delegate away its fiduciary responsibility (and legal liability) for appointing the manager to carry out these duties.

This responsibility obligates the plan sponsor to document its due diligence process in:

1. Selecting the 3(38) investment manager and
2. Monitoring and reviewing the 3(38) investment manager

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<sup>1</sup> In considering the category for a lifecycle/target retirement date alternative, the DOL presumed that when a participant fails to direct the investment of assets, the only readily available and objective information relevant to making an investment decision is "age." When age is used as the criteria, the DOL does not require the investment manager to take into account other demographics; such as risk tolerance, other investments, salary, or individual preferences. Furthermore, when a manager allocates assets in order to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on a participant's age, target retirement date, or life expectancy, then the manager would only need to consider participant age; i.e. managed model portfolios.

## **DALBAR ERISA 3(38) Due Diligence Program**

DALBAR provides each 3(38) investment manager, who successfully complete its due diligence program, with documentation (“certification”) regarding the manager’s status as an ERISA 3(38) investment manager. The manager may provide the documentation to plan sponsors.

DALBAR will also provide its certified 3(38) investment managers and their clients with:

1. Notification of any material change with the manager
2. ERISA required due diligence documentation annually

### **Due Diligence Process**

Plan sponsors may find the **DALBAR ERISA 3(38) Due Diligence Program** an essential tool in complying and documenting their due diligence process. Receipt of documentation from DALBAR, a third party who has performed a due diligence review of the manager in compliance with the Department of Labor framework for selecting service providers, may be an appropriate procedure which a plan sponsor may wish to incorporate in its due diligence process.

The DALBAR documentation may assist a plan sponsor in documenting its due diligence process in selecting, engaging, and monitoring an ERISA §3(38) investment manager. Without the Dalbar documentation, the plan sponsor would have to “figure out” how it would perform and document its due diligence process.

### **Investment Manager Contract**

**Caution:** Even though a 3(38) manager may indicate that it is accepting full fiduciary responsibility (and therefore the legal liability) for the investment options -- too often the contracts are written with language that throws this onerous responsibility back on the shoulders of the plan sponsor.

Understanding that it is the intent of the plan sponsor to appointment a 3(38) investment manager who will accept fiduciary responsibility for the investment options (thereby, providing the plan sponsor with relief from liability and from the obligation to invest or otherwise manage plan assets), a review of the manager’s contract by legal counsel may be an appropriate procedure which a plan sponsor may wish to incorporate in its due diligence process.

A review by legal counsel may assist the plan sponsor in excluding any conflicting language which may be contained in the contract which makes the plan sponsor ultimately responsible for:

1. The selection of the investment options (e.g. being required to give final approval).
2. Approving model portfolios constructed by the investment manager.
3. Determining if a model is appropriate as a QDIA under the guidelines of the DOL.
4. Deciding if additional investments and/or model portfolios should be included as available investment options for plan participants.
5. Providing unnecessary information to the manager so that the manager may construction model portfolios and/or QDIAs for the Plan; i.e. the ambiguous term demographics.
6. Any other language which compromises or contradicts the investment manager’s full and sole discretion in making investment decisions for the Plan.

### **DALBAR**

Contact Stephanie Ptak, DALBAR Executive Administrator, at [sptak@dalbar.com](mailto:sptak@dalbar.com) or (617) 624-7134 for more information about the **DALBAR ERISA 3(38) Due Diligence Program**. DALBAR has a 30-year history and is recognized by industry and government as an independent third party expert in the business of providing evaluations, ratings, and due diligence. DALBAR certifications are recognized as mark of excellence in the financial community.