Defined Contribution
Institutional Investment Association

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Defined Contribution Plan Governance Models

A Guide for Plan Sponsors

We are witnessing an evolution within the defined contribution (DC) industry in the ways plan sponsors implement DC plan governance practices. As the number of participants and assets within DC plans continue to grow, more plan sponsors seek to incorporate sophisticated institutional investing practices. These changes in the DC industry have also increased the interest in and usage of governance models that delegate some level of fiduciary responsibility to external providers. And with the passing of the Setting Every Community Up for Retirement Enhancement Act (SECURE) Act of 2019, new structures such as pooled employer plans (PEPs) are poised to further transform the governance practices used by DC plan sponsors.

Because every organization is unique in its ability, desire, and resources to fulfill its fiduciary responsibilities, DC plan sponsors often seek expert advice from and/or delegate fiduciary duties to external providers. To some extent, hiring such third-party providers can mitigate the fiduciary liability exposure of the plan's fiduciaries, including potential lawsuits. There is a spectrum of ways that plan sponsors can enlist providers to help them with their responsibilities.

This paper explores various governance models that are used by DC plan sponsors and explains the key players, common fiduciary and settlor decisions, and considerations that may help plan sponsors choose a governance model suitable for their organization. We hope this paper provides a helpful guide to plan sponsors exploring their options.

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Notes on ERISA

The Employee Retirement Income Security Act of 1974 (ERISA) is a federal law that is broadly applicable to DC plans of U.S. corporations to provide protection for individuals in these plans. Public/governmental plans and certain plans maintained by religious-affiliated employers are not governed by ERISA. Instead, they are subject to separate enabling statutes or local laws that may be similar to or different from the fiduciary duties and responsibilities under ERISA.

PRIMARY RESPONSIBILITIES OF A FIDUCIARY

The primary responsibilities of an ERISA fiduciary are to:

- Act solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing benefits and paying reasonable plan expenses.
- Act prudently.
- Follow the plan documents (to the extent the terms are consistent with ERISA).
- Diversify plan investments to minimize the risk of large losses.
- Avoid ERISA-prohibited transactions and conflicts of interest.

WHO IS A FIDUCIARY?

Fiduciary status is based on fiduciary appointments and delegations of authority and the actual fiduciary functions performed for a plan. For ERISA plans, there must always be one or more named fiduciary(ies). Traditionally, the plan sponsor or a committee or employee of the plan sponsor is designated as the plan's named fiduciary. Increasingly, third-party providers may also serve as a plan's named fiduciary.

In addition, any other individual or entity that performs the functions below for an ERISA plan is considered a fiduciary and must adhere to ERISA's fiduciary standards and prohibited transaction rules: **(Exhibit 1)**

Exhibit 1
Types of Fiduciary Responsibilities

Types of Fiduciary Responsibilities	ERISA Fiduciary Designation Section
Provides non-discretionary investment advice to a plan	3(21)
Exercises discretionary control or authority over plan management or plan assets	3(38)
Has discretionary authority or responsibility for plan administration	3(16)

In general, DC plan fiduciaries may include the plan administrator, trustee, investment consultant/advisor, investment managers, managed account provider, and — of course — the plan's named fiduciary(ies). Accountants, actuaries, recordkeepers, and attorneys are typically not fiduciaries based on the functions they perform. The roles of some of these key service providers are detailed in the Appendix.

"Discretion" in the DC Context

Simply stated, taking "discretion" is having the ability to decide what should be done in a particular situation without needing the approval of another plan fiduciary. As an example, a 3(38) fiduciary investment manager has discretion to buy and sell stocks within a portfolio. A 3(21) non-discretionary investment advisor makes recommendations or provides advice to another fiduciary for review and the other fiduciary will make the final decision to approve and/or reject the advisor's recommendations or advice.

TYPES OF DC PLAN DECISIONS

Decisions regarding a DC plan generally fall into three categories. Examples are listed below:

Settlor	Fiduciary	Non-Fiduciary
• Plan type • Eligibility and match rules • Contribution types • Distribution types • Deciding to amend or terminate the plan	• Establishing fiduciary governance structure • Investment menu and investment policy • Selecting investment options • Approval of plan expenses • Selecting trustee and third-party providers	• Most recordkeeping services • Enrollment and allocation of contributions • Facilitation of distributions and loans • Ministerial duties

Settlor decisions, which include decisions related to plan design features, fall to the plan sponsor (or legislative body for public entities) and are not ERISA fiduciary duties. Note that a plan sponsor can act as the named fiduciary, but often plan sponsors will delegate fiduciary decision making, such as to a fiduciary committee established by the plan sponsor to serve as the plan's named fiduciary.

Oversight and implementation of fiduciary decisions and plan administration tasks are the purview of the plan's named fiduciaries (although named-fiduciary duties can be shared or delegated by a plan's named fiduciaries to third-party providers that serve as named fiduciaries or 3(21), 3(28), or 3(16) plan fiduciaries). The plan fiduciary can also appoint non-fiduciary service providers to help carry out their fiduciary duties.

The rest of this paper takes an in-depth look at how plan sponsors can fulfill their fiduciary and administrative responsibilities and various arrangements through which they can leverage external expertise and resources.

THE ROLE OF A 3(21) FIDUCIARY

A 3(21) fiduciary is often called a 3(21) consultant, 3(21) investment advisor, co-fiduciary, or non-discretionary consultant.

A common example of a 3(21) fiduciary is an investment consultant/advisor who provides recommendations and advice to the plan's named fiduciary but does not make discretionary decisions regarding a DC plan's investments or administration. The term 3(21) refers to the section of ERISA that defines an ERISA fiduciary and describes the types of investment advice that would lead to someone being considered a fiduciary under ERISA.

Named fiduciaries who need help making prudent investment decisions often engage a 3(21) investment consultant/advisor to assist them with fiduciary duties. These duties include changes in the plan's fiduciary governance structure or investment policy; the selection, structuring, and monitoring of investments; and reviewing investment fees, fund administration, and/or custody of assets. These investment advisors act in a non-discretionary capacity, allowing the plan's named fiduciaries to make final decisions.

While engagements between a plan sponsor and a 3(21) consultant/advisor vary based on the desired services, consultants may offer different suites of services, including those listed in **Exhibit 2**:

Exhibit 2
3(21) Consultant Services

Investments
• Advice on fiduciary governance structure
• Investment policy development
• Investment menu design
• Invetment options structure (e.g., white label, multi-manager)
• Investment manager searches, benchmarking, monitoring
• Advice on selection of default investment options (e.g., QDIA)
• Advice on selection of managed accounts provider
• Related non-fiduciary investment services (e.g., financial wellness)
• Review/benchmarking of fees paid to fiduciaries and providers and total plan cost/fee analyses

IMPLEMENTATION OF 3(21) SERVICES

When engaging a 3(21) consultant/advisor, the plan sponsor retains discretion and makes final decisions for which it receives recommendations or advice from the 3(21) fiduciary, as illustrated in the example.

EXAMPLE: A committee is searching for a replacement investment manager at the recommendation of its consultant. During the search process, the consultant provides information and analytics to the committee on multiple managers, along with its recommendation. It is the committee's responsibility to decide whether to replace the existing manager and select the new manager(s), select the investment strategy and investment vehicle or separately managed account structure, determine how the existing assets will be transitioned, and review and execute any investment manager agreements.

It is common for a plan sponsor to hire a 3(21) consultant for an ongoing engagement or retainer. In other cases, a plan sponsor may hire consultants for periodic project work such as fee reviews, investment manager searches, or recordkeeping requests for proposals (RFPs). A common fee arrangement is a flat dollar fee; an asset-based fee is less typical for a 3(21) fiduciary. The fee may be paid by the employer/plan sponsor or the plan, if provided for in the plan documents.

THE ROLE OF A 3(38) FIDUCIARY

A 3(38) fiduciary is often called a 3(38) manager, investment manager, 3(38) investment manager, outsourced chief investment officer (OCIO), or delegated or discretionary consultant.

A 3(38) fiduciary is another type of ERISA fiduciary that provides investment expertise to DC plan named fiduciaries on a discretionary basis. The name 3(38) refers to the section of ERISA that defines a discretionary investment manager.

A 3(38) fiduciary can be appointed for a specific strategy or strategies, whereas a 3(38) OCIO often will exercise discretion broadly across the plan's investment program. **Exhibit 3** lists examples of investment responsibilities that may be delegated to a discretionary 3(38) OCIO fiduciary, alongside common duties of a non-discretionary 3(21) fiduciary advisor for comparison:

Exhibit 3
Fiduciary Services

Investments	3(21) Non-discretionary Advice	3(38) OCIO Discretionary Management
• Investment policy design	√	√
• Investment menu design	√	√
• Investment option structures (e.g., white label, multi-manager)	√	√
• Investment manager searches, benchmarking, monitoring	√	√
• Investment vehicles and fee evaluations	√	√
• Default investment selection (e.g., QDIA)	√	√
• Managed accounts	√	√
• Total plan cost/fee analyses	√	

Asset managers, investment consultants, banks, insurers, and investment advisors can act as 3(38) OCIO fiduciaries if they meet the conditions set out in ERISA Section 3(38). Because of the diversity of providers, there is a range of names, services, and levels that reflect what 3(38) services may entail. Not all 3(38) OCIO fiduciaries offer all services, so it's important to consider which services are needed.

IMPLEMENTATION OF 3(38) OCIO SERVICES

In addition to various providers offering 3(38) OCIO services to DC plans, there are different ways of implementing these services. A plan sponsor can delegate some or all of the above-referenced responsibilities depending on its needs. Below are four examples of how 3(38) OCIO fiduciary services might be delegated:

- A plan's investment committee has an investment policy statement that specifies the plan's intent is to qualify as an "ERISA section 404(c) plan." It also says the 3(38) OCIO fiduciary is responsible for determining the number and types of investment options (including the QDIA), and for selecting and terminating investment managers. The committee has outsourced all investment-related decisions to the 3(38) OCIO provider.
- A plan's investment committee has hired a discretionary investment consultant to oversee the plan's investment structure. In this situation, the 3(38) fiduciary creates a menu of core investment options or "buckets" and identifies how many investment options should be active and passive, how many funds are included for each asset class, and so on. But the investment committee selects the investment managers or strategies to fit within each bucket.
- A plan's investment committee is responsible for the investment structure but hires a discretionary investment consultant to select and monitor the investment managers in each of the designated buckets. This is sometimes referred to as a "manager of managers" discretionary service. In this case, the consultant doesn't make underlying security selections (such as whether to buy, hold or sell IBM in a U.S. equity investment), but instead hires one or more asset managers who decide which securities to buy, hold, or sell.
- A plan's investment committee hires a 3(38) fiduciary to take discretion over the design of a multi-manager portfolio, such as a custom target-date fund series. This is where the 3(38) fiduciary could be responsible for some or all of the following: hiring and firing the underlying managers, deciding on the asset allocation or glidepath, and conducting the monthly or quarterly rebalancing and equity roll down of the target-date fund vintages.

The fee arrangement for 3(38) fiduciary services can be asset-based or a flat dollar fee. When asset-based fees are used, the fee is often paid from the plan assets and is dynamic — the dollars paid change subject to the size of the assets. When a flat dollar fee is paid, it can also be paid from the plan assets, but it is static, regardless of the asset size. Historically, an asset-based fee has been more common, but flat dollar fees are now being used more frequently so plan sponsors can budget the cost and compare providers' fees on an apples-to-apples basis regardless of plan size.

USAGE OF 3(21) AND 3(38) FIDUCIARIES BY DC PLANS

According to Callan's 2022 Defined Contribution Study (conducted in fall 2021), which surveys sponsors of plans greater than $100 million, 70% of respondents that reported working with a retainer investment consultant did so on a 3(21) non-discretionary basis.[1]

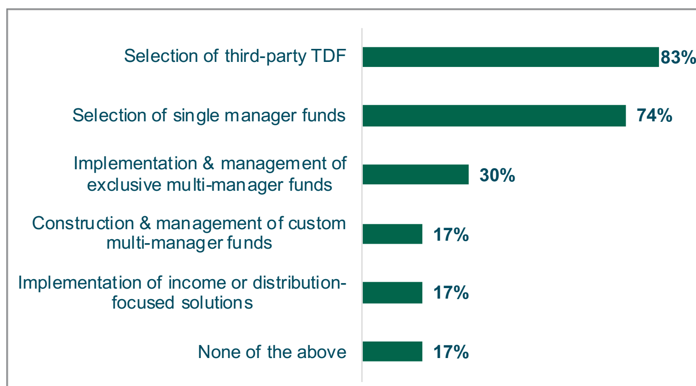
[1] Callan, *2022 Defined Contribution Trends Survey*, March 2022

The use of a 3(38) OCIO fiduciary by U.S. institutions outside of DC plans (i.e., defined benefit plans, endowments, foundations, etc.) to provide discretionary investment consulting services has been growing quickly and is currently at approximately $1.1 trillion assets under management, according to Cerulli Associates, which predicts this to grow to nearly $1.7 trillion by 2023.[2]

While the use of a 3(38) OCIO fiduciary to provide discretionary investment consulting services in DC plans hasn't been as common, this market segment has had the largest growth in assets under management (AUM) in the year ended March 31, 2021, up 54.8% to $246.4 billion, according to a recent Pensions & Investments survey.[3] One reason for this growth may be that more organizations are no longer offering a defined benefit plan and therefore have fewer investment staff with the expertise or capacity to handle the work required of a DC plan fiduciary. There is also significant ERISA litigation against DC plans, so some DC plan sponsors might use 3(38) fiduciaries to provide increased expertise and possibly manage litigation risk.

The selection of third-party target-date funds and single-manager funds were by far the most widely used 3(38) fiduciary investment consulting services, according to a survey of DC plan sponsors and 3(38) OCIO fiduciary providers published in early 2021 by PGIM, the asset management business of Prudential. In a distant third place was the implementation and management of exclusive multi-manager funds. Additionally, PGIM reported that the use of a 3(38) OCIO fiduciary to provide discretionary investment consulting services is most common in DC plans with $250 million to $500 million in 401(k) assets.[4]

Exhibit 4
Services Utililized by Plans That Employ an OCIO



Source: PGIM

3(21) AND 3(38) FIDUCIARY CONSIDERATIONS

When considering whether to hire a 3(21) or 3(38) fiduciary to provide investment consulting services, plan sponsors and/or their investment committees should carefully evaluate how much investment expertise, time, and internal resources they have to fully meet the responsibilities of selecting and monitoring their DC plan's investments and fees on an ongoing basis and compare that to the cost of outsourcing such services.

For those with more experience managing a retirement plan and enough investment expertise to be comfortable making decisions, hiring a 3(21) fiduciary to provide additional support, analysis, and input into the decision-making process may be a good fit. For those who aren't as confident that they can meet their responsibilities on their own, or for those seeking an additional tool to mitigate litigation risk, hiring a 3(38) fiduciary may be a better fit.

Since many 3(21) and 3(38) investment consultants also offer a broad suite of discretionary investment consulting and investment management services (and pooled investment vehicles), plan sponsors should consider potential conflicts of interest or independence concerns, particularly if they are considering using both discretionary and nondiscretionary investment consulting and investment management services. For example, a 3(21) consultant recommending its proprietary investment products could lead to conflicts of interest. Plan sponsors should ask about potential conflicts and how conflicts are managed within applicable legal and regulatory restrictions.

The top three reasons cited by DC plan sponsors for using a 3(38) OCIO fiduciary investment consultant include:

- Desire for expertise in implementing institutional quality structures.
- Perceived mitigation of fiduciary risk.
- Insufficient in-house investment sophistication[5].

[2] Cerulli Associates, *OCIO at an Inflection Point*, March 2019

[3] *Pensions & Investments*, "OCIO rides market rebound to big growth," June 28, 2021

[4] PGIM, *The Evolving DC Landscape: The Expanding Role of OCIOs*, 2021. PGIM's research was conducted by Greenwich Associates in 2020 covering 138 plan sponsors with at least $100m in 401(k) assets. 16% of plan sponsors reported using the services of an OCIO provider.

[5] Ibid.

THE ROLE OF A 3(16) FIDUCIARY

A 3(16) fiduciary or "plan administrator" is responsible for managing the day-to-day administration of a plan, including compliance with ERISA guidelines.

Another ERISA fiduciary is the 3(16) fiduciary, or the "plan administrator." The term 3(16) refers to the section of ERISA that defines a plan administrator. Under this section, if no party is named as the plan administrator, it defaults to the sponsor of the plan. Also, by default, a 3(16) fiduciary is responsible for plan administrative tasks (different from the investment responsibilities described above).

Plan sponsors may contract with third parties as 3(16) fiduciary designees to take on some administrative duties. In this case, the administrative service provider accepts responsibility for those functions in a fiduciary capacity. Alternatively, the plan sponsor may contract the service provider to perform administration tasks (in part or in whole) in a non-fiduciary capacity. There are two manners of creating third-party 3(16) fiduciary duties: Either a party accepts status as the ERISA Section 3(16) plan administrator, or it performs administrative tasks that are fiduciary in nature. Examples of administrative duties that could involve such discretion or control creating fiduciary status, versus administrative services that are non-fiduciary, include:

IMPLEMENTATION OF 3(16) SERVICES

Similar to 3(38) fiduciary services, outsourcing to a 3(16) fiduciary entails the transfer of decision-making authority or control for items within the scope of services. The transfer of authority may likely include a change in process (e.g., re-routing participant loan approvals), which should be documented in the employer's administrative manual and communicated to plan participants where relevant.

More DC plan sponsors are exploring the availability of 3(16) services. Many already employ elements of administrative outsourcing to their recordkeeper (e.g., hardship approvals, preparation of 5500 forms, etc.) in a non-fiduciary capacity. Some are now looking to outsource not only the work, but also the fiduciary discretion or control, as a means to minimize workloads and/or mitigate ERISA liability.

ERISA administrative outsourcing opportunities are not uniform and differences in the outsourced work and the liability accepted by providers can vary widely. Many contracts for these services have an "a la carte" structure for the types of items covered under the agreement.

Exhibit 5
3(16) Services

	Non-Fiduciary Admin Duties	Fiduciary Admin Duties
• Interpret plan document and make discretionary decisions regarding ERISA compliance		√
• Move assets, implement trades and rebalance or facilitate transactions in a non-directed manner (i.e., with discretion or control)		√
• Make discretionary decisions for the plan to achieve compliance with law		√
• Make discretionary decisions on determining loan and hardship withdrawal eligibility based on plan provisions		√
• Write checks (with control and without requiring direction)		√
• Enroll participants and facilitate participant transactions in a directed capacity	√	
• Provide non-discretionary education support, advice tools, and statements	√	
• Implement (in a directed capacity, trades and rebalancing transactions to directed trustee)	√	
• Facilitate plan distributions and loans in a directed capacity	√	
• Prepare administrative aspects of form 5500 filing for review and sign-off by a fiduciary	√	
• Perform clerical and ministerial services	√	
• Perform lost-participant searches	√	
• Evaluate compliance with ERISA regulations for consideration by plan fiduciary	√	
• Assist with determining loan and hardship withdrawal eligibility pursuant to specific established guidelines on a nondiscretionary basis	√	

3(16) FIDUCIARY CONSIDERATIONS

Given the responsibilities of a 3(16) fiduciary, a provider's technological capabilities and knowledge, skill, and experience with plan administration is important. Connectivity to the recordkeeper (when the 3(16) fiduciary is unrelated) also matters to ensure a quality service experience for plan participants.

Plan sponsors must consider which administrative duties should be kept in house or outsourced (typically to the plan recordkeeper and/or the third-party administrator). The decision often revolves around efficiency, workload capacity, and the desired level of control/influence on administrative decisions. If a decision is made to outsource, the question becomes whether to "direct" the work and retain fiduciary responsibility, or to "turn over" the work to a 3(16) fiduciary. It is very typical for service agreements to have a mix of administrative activity that is (a) retained (b) directed (i.e., non-fiduciary) and (c) fiduciary outsourced.

Hardship withdrawal approvals can be an example of a duty that has mixed outsourcing, where the fiduciary decision-making around when to allow hardship withdrawals is retained by the plan sponsor, but non-fiduciary administration is outsourced. The review and approval process can be retained by the plan sponsor, typically the human resources (HR) team. HR documents the evaluation of each request, informs the recordkeeper of the decision and retains the records. The approvals can be directed to a recordkeeper by, for example, designating the approval process as needed to meet safe harbor standards where the recordkeeper does the implementation work in a directed capacity but the plan sponsor retains the ultimate decision-making where questions are raised, and therefore retains the fiduciary responsibility for its decision-making authority. A different model could be for the decisions to be completely outsourced to a recordkeeper or a third-party administrator, where the outside party becomes responsible for the decision-making authority/control over the participant approvals. In that alternative approach, the administrator is taking on fiduciary responsibility.

Finally, given the degree of variability of ERISA 3(16) services in the market, scrutiny of the service agreement is of paramount importance. This includes understanding exactly what is covered (or excluded) within the scope of services and from the administrator's fiduciary and directed or ministerial responsibilities, any limits of liability, and the indemnification provisions. Plan sponsors should also review the financial wherewithal of the selected provider relative to potential claims and any applicable insurance limits, among other considerations.

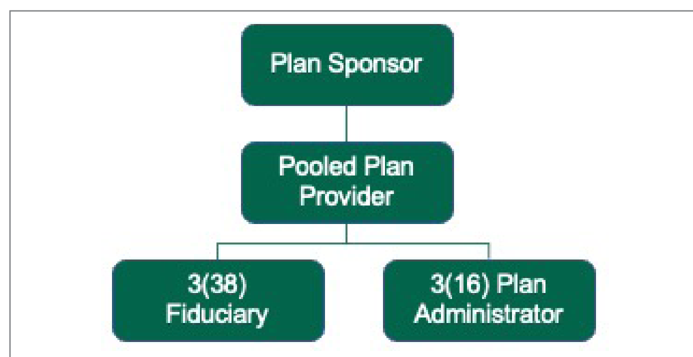
ROLE OF POOLED PLAN PROVIDER (PPP)

Under the SECURE Act of 2019, a plan sponsor can hire a pooled plan provider (PPP) to perform the roles of the 3(16) plan administrator and serve as the 3(38) named fiduciary within a solution called a pooled employer plan (PEP).

POOLED EMPLOYER PLANS (PEPS)

The SECURE Act of 2019 laid the groundwork for an expansion of what were previously referred to as multiple-employer plans. This effectively expanded the universe of employers who could choose to participate in a pooled plan by no longer requiring two employers to share a "common nexus" or association. Removing the "common nexus" constraint allowed employers from any industry to outsource the management of their DC plan to a single plan called a pooled employer plan (PEP). The intended goal of PEPs is to allow plan sponsors even greater scale when procuring plan management and fiduciary services, while also allowing employers to limit decisions and administration involved with sponsoring a DC plan.

Exhibit 6
PEPs



When managing a PEP, the PPP can decide to retain 3(16) and/or 3(38) responsibilities or to further outsource those roles to a third-party service provider. Within a PEP environment, the PPP can be directly responsible — or hire an outsourced third-party — for duties such as: managing plan administration, recordkeeping, and selecting and monitoring the investment options and underlying investment managers.

As with other types of outsourcing, both the employer and PPP may be sacrificing a degree of control for ease. Some of the many reasons why plan sponsors would hire a PPP are to reduce their administrative burdens, achieve cost efficiencies, seek expertise not available at the plan sponsor, and mitigate their fiduciary burden. However, as with any fiduciary delegation, it may not be possible to eliminate administrative burdens and fiduciary responsibilities. The plan sponsor still has some residual responsibilities, including the selection, monitoring, and benchmarking of their PPP, arranging for contributions to be made timely and such other duties and responsibilities set forth in the PEP plan documents.

Keep in mind that PEPs are an emerging area, so it's premature to conclude which PPP model or roles and responsibilities will emerge as a standard or industry norm.

PPP SERVICES

The services offered by PPPs vary in scope and fiduciary coverage. It's important to review and evaluate what is **included** in a PPP's proposed scope of services and corresponding contract documentation, and more importantly, what plan administration and fiduciary responsibilities are **excluded** (e.g., responsibilities to make timely fund contributions, tracking down beneficiaries, processing qualified domestic relations orders and hardships, providing paper notices to participants who can't receive electronic notices, and fiduciary responsibility for selecting and monitoring vendors servicing the PEP). Plan sponsors should fully understand the delegation of responsibilities to ensure it aligns with their needs and expectations.

The table below summarizes the basic DC plan services and which party is typically responsible for them when a DC plan participates in a PEP. (**Exhibit 7**)

Exhibit 7
PPP Services

	Plan Sponsor (PS)	PPP (or a PEP Vendor)
• Plan design features	√*	√*
• Investment menu		√
• Plan administration		√
• Selection of providers (e.g., trustee, 3(38) advisor, recordkeeper, other non-fiduciary service providers, etc.)		√**
• Selection of PPP	√	

** Plan design features may be determined by the plan sponsor within the limits imposed by the PEP.*
*** Typically, the PPP identifies and retains the plan providers, but the plan sponsor may need to sign off and approve the selections.*

When evaluating PPPs, it's important to identify and review any possible conflicts of interest between the parties involved, including the PPP, 3(16) administrator, 3(38) investment advisor, trustee/custodian, and recordkeeper. Key issues are the presence of conflicts and how such conflicts are managed within applicable legal and regulatory restrictions. Examples of potential conflicts include use of the provider's proprietary funds in the plan's investment lineup or the PPP's decision to retain itself to provide additional services to the PEP. However, PPPs that leverage vertical integration can typically quote lower costs than those providing unbundled services.

IMPLEMENTATION OF A PEP

While a PEP can offer employers a "turnkey" or "bundled" DC solution, there is often some latitude when it comes to implementation. A PEP could be fully flexible on plan design features by using a pre-approved design like a volume submitter plan or offer a limited number of plan design options. For example, plan sponsors may be able to choose an employer-match structure and/or the types of funds offered within the lineup. In other models, the plan sponsor would adopt the PEP's standard plan features and investment menu design. In short, there can be a degree of flexibility depending on the PPP, but a flexible arrangement might cost more.

PEP FEE CONSIDERATIONS

Understanding PEP fees — including plan administration, recordkeeping, trustee, and investment fund expense — is an important step in the review process. Plan sponsors, as the plan fiduciary, should seek to evaluate if the PPP offers reasonable fees for the services their PEP provides. They also should understand participant fee structures (e.g., asset-based or dollars per participant) and any expenses borne by the plan and/or the plan sponsor. In addition, the plan sponsor may want to consider any additional costs associated with search, selection, and benchmarking of the PPP over time.

PPP AND PEP POTENTIAL IMPACT ON DC MARKET

Given that the PPP and PEP landscapes are still emerging, it remains to be seen how they will alter the DC landscape. Some big questions are:

- What type of employer and/or size of DC plans will move to a PEP model?
  - The SECURE Act framed PEPs as a way to address the retirement coverage gap. Smaller DC plans and companies not currently offering a DC plan were the intended target market. However, the rules do not preclude larger DC plans from moving to a PEP model, which is why some are currently betting the large end of the market may move toward PEPs as well. Either way, it remains to be seen whether PEPs will attract large or small DC plans, or both.
- How will PEPs impact the advisor/recordkeeper relationship?
  - Early entrants include large consulting firms acting as the PPP and selecting a third-party recordkeeper for the PEP. In other cases, recordkeepers are creating a singular model that doesn't currently compete with PEPs offered by consulting firms.

- As PEPs grow in size and negotiating power, will they accelerate the fee compression for services in the DC industry for the benefit of the end participant?
- Will the differentiation for PEPs be their ability to bring more institutional investment best practices to a broader swath of participants?
  - For example, over time will PEPs compete by offering multi-manager fund structures, custom solutions, alternative investments, cutting-edge fintech and/or retirement-income solutions?

NEXT STEPS FOR OUTSOURCING TO A FIDUCIARY

If a plan sponsor is unsure which type of fiduciary support is right for their plan, there are specialized third-party evaluators that do not perform fiduciary services but can help plan sponsors identify the optimal fiduciary support model. These evaluators are well-versed in 3(21) and 3(38) services and providers. Not all evaluators currently cover 3(16) and PEP models, but these markets are growing so more are likely to do so soon.

Once a plan sponsor decides what, if any, type of fiduciary is needed, completing due diligence is important. A plan sponsor can conduct the due diligence itself or hire a third-party evaluator to assist and/or lead a search.

If the plan sponsor chooses the former, the process generally starts by conducting a search of viable candidates. Next, a request for proposal (RFP) is developed and issued to those candidates, followed by an evaluation of the responses, final presentations and selection of the most appropriate candidate. If the plan sponsor prefers, an independent consultant or third-party evaluator, benefits consultant, and/or the plan's outside legal counsel can assist with this process for an additional fee.

The appendix includes a case study that compares the services and decision-making authority across each fiduciary support model.

CONCLUSION

It is often repeated that regulation and litigation can slow or restrict innovation. Perhaps the evolution of the plan governance changes described in this paper can prove the exception to the rule. Legal and regulatory forces are pushing fiduciaries to enhance fee transparency, reduce frictional costs and improve plan governance for plans of all sizes. Outsourcing fiduciary responsibility and pooling plans to reduce administrative and investment costs could ultimately yield positive results for the U.S. retirement ecosystem.

APPENDIX A

Case Study - Reviewing Different Settlor and Fiduciary Service Models

Background: XYZ Company wants to take a fresh look at the governance model for its 401(k) plan and engaged a specialized third-party evaluator to help compare service models. XYZ has long engaged a 3(21) fiduciary where its investment consultant provides advice on their plan's investments and the committee makes the final decisions. Of interest is how the company and fiduciary committee's decision-making authority could vary for different decisions and tasks — such as plan design, investments, and administration — across different service models, such as 3(38) versus PPP.

Exhibit 8 summarizes the results of XYZ's review. It learned three things: Certain providers offer both 3(21) and 3(38) services. It could tailor the services to the unique needs of its plan. And as more duties are outsourced to a third party, the scope and number of decisions required of the fiduciary committee is reduced.

Note that different case studies and/or searches may yield different results.

Exhibit 8

XYZ Company Settlor and Fiduciary Service Model Comparison

Decisions & Tasks	Decision Type	Service Models Final Decision-Making Authority			
		3(21)	3(38) OCIO	3(16)	PPP
Plan Design					
Eligibility rules	**Settlor**	PS	PS	PS	PS
Allowable contribution types	**Settlor**	PS	PS	PS	√
Company match formula	**Settlor**	PS	PS	PS	PS
Available distribution types	**Settlor**	PS	PS	PS	√
Types and number of loans	**Settlor**	PS	PS	PS / √	√
Plan document interpretation and ERISA compliance	**Fiduciary**	NF	NF / √*	√	√
Plan Investments					
Investment policy development	**Fiduciary**	NF	NF	N/A	√
Investment menu design	**Fiduciary**	NF	√	N/A	√
Investment option structures (e.g., white label, multi-manager)	**Fiduciary**	NF	√	N/A	√
Investment manager searches, benchmarking, monitoring	**Fiduciary**	NF	√	N/A	√
Investment vehicles selection	**Fiduciary**	NF	√	N/A	√
Default investment selection (e.g., QDIA)	**Fiduciary**	NF	√	N/A	√
Managed accounts provider selection	**Fiduciary**	NF	√	N/A	√

PS Plan Sponsor (e.g., employer)
NF Named Fiduciary (e.g., fiduciary committee)
√ External provider (e.g., 3(38) fiduciary, 3(16) administrator, PPP)
PS / √ Combined effort between an external provider and the plan sponsor
NF / √* External provider can be engaged to assist plan sponsors with oversight

Exhibit 8 continues on next page.

Exhibit 8 continued

XYZ Company Settlor and Fiduciary Service Model Comparison

Decisions & Tasks	Decision Type	Service Models Final Decision-Making Authority			
		3(21)	3(38) OCIO	3(16)	PPP
Plan Administration					
Facilitate withholdings and send contributions to recordkeeper / trustee / custodian	**Administrative**	N/A	N/A	PS	PS
Enroll participants and facilitate participant transactions	**Administrative**	N/A	N/A	√	√
Provide education support, advice tools, statements	**Administrative**	N/A	N/A	√	√
Send trades and rebalancing transactions to directed trustee	**Administrative**	N/A	N/A	√	√
Facilitate plan distributions and loans	**Administrative**	N/A	N/A	√	√
Find lost participants	**Administrative**	N/A	N/A	PS / √	PS / √
File form 5500	**Fiduciary**	N/A	N/A	√	√
Determine structure of plan administration fees	**Fiduciary**	NF	NF	NF	√
Review and negotiate provider fees	**Fiduciary**	NF	NF	NF	√
Selection and Monitoring of Providers					
Recordkeeper and/or third-party administrator	**Fiduciary**	NF	NF	NF	√
Directed trustee and custodian	**Fiduciary**	NF	NF	NF	√
3(21) or 3(38) plan fiduciaries	**Fiduciary**	NF	NF	NF	√
Pooled Plan Provider (PPP)	**Fiduciary**	N/A	N/A	N/A	NF

PS Plan Sponsor (e.g., employer)
NF Named Fiduciary (e.g., fiduciary committee)
√ External provider (e.g., 3(38) fiduciary, 3(16) administrator, PPP)
PS / √ Combined effort between an external provider and the plan sponsor
NF / √* External provider can be engaged to assist plan sponsors with oversight

APPENDIX B

Defined Contribution Ecosystem: Roles of Key Service Providers

Plan Sponsor: The plan sponsor, or named fiduciary, is the entity that establishes a DC plan for the benefit of participants and beneficiaries. This is often the employer, but it can be a person or entity appointed by the employer (e.g., a benefits committee). An employer might appoint a committee as the plan sponsor and named fiduciary to delegate risk or for other reasons. Within the public sector, such as a state's deferred compensation plan, the plan sponsor and named fiduciary is typically identified through statute and is often a board or committee.

Plan Administrator: A plan administrator is responsible for all aspects of plan administration. This can be handled internally but is often outsourced to a third party. The administrator handles tasks such as processing loans, required notices, and distributions. In some cases, the plan administrator operates as a 3(16) fiduciary in part or in full.

Trustee: The duties of a trustee are to hold assets (subject to outsourcing to a custodian, see below) and — if not delegated to a custodian — perform functions related to holding assets, such as reporting asset valuations; performing tax, regulatory, and other reporting requirements; and processing recurring and lump-sum payments to participants at the direction of the plan administrator. Additionally, most trustees are "directed," meaning they do not take discretion over their activities but instead follow pre-determined instructions.

Custodian: A custodian is a financial institution responsible for holding and safekeeping assets, typically as a delegate of a trustee. Custodians process and value assets they hold. An important distinction is that the custodian cannot buy, sell, transfer, or move assets unless explicitly instructed to do so by the trustee. Often, trustee and custody services are bundled together, and in many cases are included with the recordkeeping arrangement.

Recordkeeper: As the name implies, they are the keeper of records for the DC plan. Recordkeepers track participant information such as account status, balances, contributions, and all transactions within an account as well as other technical information about the plan. Recordkeepers often provide participant communications and education. They also might serve as a 3(16) fiduciary in part or in full.

Consultant/Advisor: Consultants can operate as 3(21) and/or 3(38) fiduciaries. In the more traditional 3(21) role, consultants provide education, review the plan's investments and fees, and make recommendations to the plan sponsor, but do not make decisions. In a 3(38) capacity, consultants expand their role and take discretion in part or in full over certain aspects of the DC plan, most commonly the investment selection, monitoring, and termination decisions, although the amount and extent of discretion varies substantially by engagement.

Investment Manager: Operating as a 3(38) fiduciary, investment managers are responsible for managing the assets of a plan consistent with the investment fund or manager's stated investment philosophy, guidelines, and style, in a discretionary (decision-making) capacity.

ABOUT DCIIA

The Defined Contribution Institutional Investment Association (DCIIA) is a nonprofit association dedicated to enhancing the retirement security of America's workers. To do this, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution outcomes. DCIIA's diverse group of members include investment managers, consultants and advisors, law firms, recordkeepers, insurance companies, plan sponsors and other thought leaders who are collectively committed to the best interests of plan participants. For more information, visit: www.dciia.org.

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