



## Dear Prudence: What is Prudence Anyway?



When it comes to monitoring and selecting investments, the responsibility lies with the ERISA fiduciary for managing your company's 401(k) plan, and this means the fiduciary is subject to ERISA's prudent man rule (sometimes referred to as the "prudent expert rule"). What *exactly* is a prudent expert?

With respect to investments, the fiduciary is responsible for selecting and monitoring the investment alternatives that are available under the plan. Acting on behalf of the plan in this way means that someone is exercising the care, skill, prudence and diligence that a prudent person familiar with such matters would exercise in similar circumstances. This expert is giving "appropriate consideration" to all the facts and circumstances that they know, or should know, are relevant to either the investment itself or to the course of action the investment requires.

This prudent expert is also selecting investment options as laid out in ERISA section 404(a). Furthermore, a prudent expert should be maintaining and following a written investment policy statement (IPS). Although ERISA doesn't require a written IPS, it is considered best practice to maintain one and follow it because it will be requested by the DOL in any audit situation, and it provides evidence that a prudent process has been adopted by fiduciaries.

A person or entity can be considered a prudent expert if they possess enough expertise to accept full personal responsibility for managing long-term investments. This is a sizable liability, and if you're not completely confident in your ability to take on that responsibility, then you can (and ERISA says you should) engage a trusted advisor to assist with this responsibility and act solely in the best interest of the plan participants.

A qualified advisor will accept, in writing, the fiduciary responsibility for their recommendations as a 3(21) fiduciary investment advisor or for their actions as a 3(38) fiduciary investment manager. The nuance here is that a 3(21) fiduciary is making recommendations to the employer or to the Plan Committee, who will then consider and make the final say and therefore retain fiduciary responsibility. But in a 3(38)



engagement, the fiduciary investment manager is transferred discretion to select and monitor (via prudent process with the IPS, etc.) investments for the plan, and then reports *back* to the employer or committee the actions they took and why it was prudent to do so.

The 3(38) scenario is where the language above is so important that it bears repeating: Acting on behalf of a plan means the entity monitoring and selecting investments exercises everything a prudent person familiar with such matters would exercise. A third party 3(38) fiduciary is often hired when there is no in-house “prudent expert” available to assume the full financial responsibility of selecting and monitoring investments and the plan sponsor wishes to outsource the responsibility.

We hope this clarifies ERISA’s prudent man rule. If you have questions about which lanes 3(21) or 3(38) fiduciaries follow—or about any other ERISA nuance—reach out and we will be happy to walk through it with you.

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