

Employee Relations

LAW JOURNAL

Employee Benefits

Hands On or Hands Off: A Plan Sponsor's Guide to Picking a Section 3(21) Investment Advisor or Section 3(38) Investment Manager

By Mark E. Bokert and Alan Hahn

Under the Employee Retirement Income Security Act of 1974 (ERISA), fiduciary responsibility lies at the heart of retirement-plan governance. The statute imposes on plan sponsors the duties of loyalty, prudence, and diversification under Section 404(a), among others. A recurring question for plan sponsors is whether to engage an investment advisor who acts under ERISA Section 3(21) or to delegate full discretionary authority to an investment manager under Section 3(38).

This column explains the differences between these two fiduciary roles, outlines the advantages and disadvantages of each, and provides guidance for plan sponsors regardless of which path they choose.

STATUTORY AND REGULATORY FRAMEWORK

ERISA Section 3(21) defines a fiduciary to include any person who renders investment advice for a fee or other compensation with respect to plan assets or who has authority or responsibility to do so. ERISA

Mark E. Bokert is a partner and co-chairs the Benefits + Compensation Practice Group of Davis+Gilbert LLP. His practice encompasses nearly all aspects of executive compensation and employee benefits, including matters related to equity plans, deferred compensation plans, phantom equity plans, qualified retirement plans, and welfare plans. Mr. Bokert may be contacted at mbokert@dglaw.com. Alan Hahn is a partner and co-chairs the firm's Benefits + Compensation Practice Group. His practice is devoted to advising clients of all sizes, including in the design and implementation of a wide variety of creative, unique, and tax-effective employee benefit plans and programs. Mr. Hahn may be contacted at ahahn@dglaw.com.

Section 3(38) defines an “investment manager” as a fiduciary who has discretionary authority to manage, acquire, or dispose of plan assets and who must be a bank, insurance company, or registered investment advisor. Both types of fiduciaries are bound by the same prudence and loyalty standards under Section 404(a), and Section 405 of ERISA imposes potential co-fiduciary liability when one fiduciary participates knowingly in another’s breach or fails to remedy it.

OPERATIONAL DISTINCTION: ADVISOR VERSUS INVESTMENT MANAGER

While the fiduciary standard is identical for both, the scope of authority is very different. A Section 3(21) fiduciary provides investment advice and recommendations to the plan sponsor or committee, but the ultimate decision-making authority remains with that sponsor or committee.

In contrast, a Section 3(38) fiduciary has full discretionary authority to implement investment decisions, select and monitor funds, and make changes to the investment lineup without needing committee approval.

In short, the Section 3(21) relationship is advisory – “we’ll advise you, you decide” – while the Section 3(38) relationship is discretionary – “we decide and execute.”

ADVANTAGES OF THE SECTION 3(21) ADVISOR MODEL

The Section 3(21) model offers important benefits for plan sponsors, particularly those who desire to maintain active oversight of their plan’s investments. It allows the sponsor to retain control over investment decisions, ensuring that plan governance remains closely tied to the organization’s broader strategy and participant demographics. By remaining directly involved, sponsors can ensure that investment decisions are consistent with the company’s culture and communication style.

The Section 3(21) approach also tends to be more cost-efficient. Because the advisor does not assume full discretionary management, advisory fees are typically lower than those charged by Section 3(38) investment managers.

In addition, the Section 3(21) model encourages transparency and engagement. The sponsor retains visibility into every investment decision, thereby fostering an active governance process. Committee members can discuss and document the reasoning behind each choice, strengthening fiduciary process and recordkeeping.

Finally, this model may allow for better alignment between investment oversight and participant education. Because the sponsor and advisor work collaboratively, changes in the investment menu can be accompanied by targeted communication strategies that explain these updates to participants.

DISADVANTAGES OF THE SECTION 3(21) ADVISOR MODEL

The principal drawback of the Section 3(21) approach is that ultimate fiduciary responsibility for investment decisions remains with the plan sponsor. The sponsor must therefore have the time and resources to evaluate recommendations and document decisions carefully.

A second challenge is the administrative and procedural burden. The sponsor or committee must review reports, and approve changes, which can slow down decision-making. Very rarely, but sometimes, the inability to act quickly can be a disadvantage.

Finally, the Section 3(21) model presumes a certain level of competence and commitment from the plan sponsor. If the sponsor's governance structure is weak or under-resourced, retaining decision-making authority could expose the organization to unnecessary fiduciary risk.

ADVANTAGES OF THE SECTION 3(38) INVESTMENT MANAGER MODE

Engaging a Section 3(38) investment manager allows the sponsor to delegate full discretion over investment management decisions. The manager selects, monitors, and replaces investment options, relieving the sponsor of that day-to-day responsibility. This structure can reduce the sponsor's operational burden and shift a portion of fiduciary liability for those decisions to the manager.

The Section 3(38) model can also improve efficiency. Because the investment manager can act immediately without waiting for committee approval, fund changes and rebalancing can occur more swiftly in response to market conditions. This may be particularly beneficial for organizations that lack an internal investment committee or dedicated staff with the expertise to monitor investment performance continuously.

Lastly, an employer's fiduciary liability insurance premiums may be reduced in a Section 3(38) model, although the magnitude of the savings may vary depending on the size of the plan.

DISADVANTAGES OF THE SECTION 3(38) INVESTMENT MANAGER MODEL

Delegating discretion under Section 3(38) often comes with higher fees, reflecting the greater responsibility assumed by the manager. Sponsors may also feel detached from the investment process and lose the ability to shape the plan's investment philosophy or participant-communication strategy. For companies that view their retirement plan as part of their broader employee-engagement platform, this loss of control may be undesirable.

There is also a common misconception that appointing a Section 3(38) manager eliminates all fiduciary exposure. While a sponsor is not responsible for the manager's investment decisions, it remains responsible for prudently selecting and, if necessary, replacing the manager. It must also monitor the manager which, as explained below, would necessitate having quarterly meetings with the manager to review and document the manager's decisions. Failure to perform those duties can itself constitute a fiduciary breach.

Finally, the Section 3(38) structure can sometimes feel too rigid for organizations that prefer a collaborative or customized approach. Because the manager operates independently, the investment lineup may evolve in ways that are not fully aligned with the company's philosophy or participant profile.

WHY MANY SPONSORS MAY PREFER THE SECTION 3(21) MODEL

Despite the appeal of delegating discretion, many plan sponsors – especially those with established governance committees – find the Section 3(21) model more consistent with their organizational goals. It allows them to maintain strategic oversight while still leveraging professional advice. This balance can be particularly valuable for sponsors who wish to coordinate investment policy with plan design, participant demographics, and communication initiatives.

Cost considerations also play a role. A Section 3(21) advisor relationship typically involves lower fees, leaving more assets in participants' accounts if advisory fees are charged to participants' accounts. For plans that already have strong internal oversight processes, there may be little added benefit in paying for the full discretionary authority of a Section 3(38) manager.

Moreover, the Section 3(21) model tends to promote stronger fiduciary engagement. Because the sponsor remains responsible for each decision, committees are incentivized to meet quarterly, review materials closely, and document their rationale. This culture of active governance often enhances both compliance and confidence.

Ultimately, the Section 3(21) structure can give sponsors the best of both worlds: expert guidance combined with retained authority. For sponsors willing to maintain disciplined oversight, it provides the flexibility to adapt the plan's investment approach while keeping costs and fiduciary risk manageable.

BEST PRACTICES FOR EITHER MODEL

Regardless of which structure a sponsor chooses, certain fiduciary principles apply equally. Every sponsor should clearly define the scope of the advisor's or manager's authority in a written agreement and ensure

that roles and responsibilities are well understood. Both parties should work under a detailed Investment Policy Statement that establishes objectives, performance benchmarks, and review procedures.

Due diligence is essential when selecting either a Section 3(21) advisor or a Section 3(38) manager. Sponsors should interview several candidates to review their credentials, registration status, experience with similar plans, and any conflicts of interest. Fees should be transparent and benchmarked regularly.

Once engaged, the advisor or manager must be monitored. For Section 3(21) advisors, sponsors should meet quarterly to review recommendations, performance data, and participant behavior metrics. As explained below, for Section 3(38) managers, sponsors should hold quarterly meetings with the manager to evaluate the manager's reports and confirm that the manager's decisions to replace or retain investments are consistent with the plan's objectives and fiduciary duties. In either case, the sponsor must document all decisions, discussions, and rationales to demonstrate its fiduciary prudence.

Even when discretion is delegated under Section 3(38), oversight cannot be abdicated. The sponsor must continue to evaluate the manager's performance and the reasonableness of fees. Termination provisions should allow the sponsor to replace the manager easily if performance or service standards decline.

ADDITIONAL THOUGHTS ON SECTION 3(38) INVESTMENT MANAGERS

Even though a Section 3(38) investment manager assumes discretionary control over investment decisions, plan sponsors should not assume that this arrangement insulates them from litigation risk. In practice, if a Section 3(38) fiduciary is sued for alleged breaches – such as imprudent fund selection, excessive fees, or failure to monitor investments – the plan sponsor would certainly be named as a co-defendant.¹ Plaintiffs would argue that the sponsor failed to prudently select, monitor, or replace the manager, which remains a core fiduciary duty under ERISA Section 404(a).² Courts have repeatedly emphasized that delegation does not equal abdication;³ the sponsor must still maintain a documented process for reviewing the manager's qualifications, performance, and fees. As a result, even though a Section 3(38) arrangement may narrow the sponsor's substantive decision-making role, it does not eliminate the practical risk of being drawn into costly fiduciary litigation whenever investment performance or plan expenses are challenged.

Further, as noted above, engaging a Section 3(38) fiduciary does not relieve the plan sponsor of ongoing oversight duties.⁴ Even after delegating investment discretion, the sponsor must meet regularly – typically on a quarterly basis – with the Section 3(38) investment manager to review the plan's investment lineup, discuss the manager's recent decisions, and evaluate

performance against established benchmarks.⁵ These meetings should cover not only fund performance but also any changes the fiduciary has made or is proposing to make, along with the rationale for those actions.

Just as importantly, the sponsor must document these discussions through formal meeting minutes that reflect the committee's review and understanding of the fiduciary's decisions.⁶ This documentation serves as critical evidence that the sponsor is prudently monitoring the Section 3(38) manager, fulfilling its own fiduciary duty under ERISA, and maintaining an appropriate governance process even within a delegated arrangement.

CONCLUSION

The decision to engage a Section 3(21) advisor or a Section 3(38) investment manager depends on each sponsor's internal resources, governance philosophy, and appetite for control versus delegation. A Section 3(38) arrangement offers convenience but at a higher cost and with less sponsor engagement. A Section 3(21) arrangement requires more involvement and accountability but allows for greater flexibility, lower fees, and closer alignment between investment oversight and overall plan strategy.

For plan sponsors with the willingness and capacity to stay engaged, the Section 3(21) model remains a compelling choice. It encourages active fiduciary governance, reinforces accountability, and provides a framework that can integrate investment oversight with participant education and plan design. In an era of heightened regulatory scrutiny and increased participant litigation, a well-documented, disciplined Section 3(21) advisory relationship – supported by a knowledgeable committee and a capable advisor – can achieve both fiduciary compliance and strategic alignment, without surrendering control of the plan's investment destiny.

Notes

1. See *Wanek v. Russell Investment Trust Co.*, 2025 US Dist. LEXIS 188662 (D. Nev. 2025).

2. See 29 C.F.R. § 2509.75-8, FR-17.

3. See *Liss v. Smith*, 991 F. Supp. 278 (S.D.N.Y. 1998) (the power to appoint carries with it the duty to monitor and remove appointees if they are not performing properly).

4. See *Howell v. Motorola, Inc.*, 633 F.3d 552 (7th Cir. 2011) (a plan sponsor has an ongoing duty to monitor those to whom it delegates investment authority).

5. The Department of Labor has long interpreted this duty to include a review at "reasonable intervals" to ensure that the appointee's performance remains consistent with the plan's objectives. 29 C.F.R. § 2509.75-8, FR-17.

6. See *Donovan v. Cunningham*, 716 F.2d 1455 (5th Cir. 1983) (fiduciary duty requires a thorough investigation of the merits of a transaction and documentation of the process).

Copyright © 2026 CCH Incorporated. All Rights Reserved. Reprinted from *Employee Relations Law Journal*, Spring 2026, Volume 51, Number 4, pages 45–50, with permission from Wolters Kluwer, New York, NY, 1-800-638-8437, www.WoltersKluwerLR.com

