

THE EXCELLENT FIDUCIARY

Eight Key Trends for ERISA Process Outsourcing

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The role of a retirement plan sponsor is multifaceted. Whether staying abreast of regulatory activity and implications, avoiding a fresh crop of fiduciary litigation, or protecting the interests and assets of a diverse employee population, the fiduciary plan sponsor's role is fraught with challenges. In recent years, the bar has been raised even higher, as heightened Department of Labor oversight in this arena has challenged traditional notions of what it means to be a fiduciary, and which entities and individuals are categorized as such.

As a result, eight key trends have emerged in the outsourcing of certain retirement plan processes in 2015:

- *TREND #1: Shifting Pricing Models*
- *TREND #2: Hiring Independent Plan Administrators*
- *TREND #3: Passing on "Multiple Hat" Vendors*
- *TREND #4: Creating Outcome-Based Contracts*
- *TREND #5: Collaborating with Service Providers*
- *TREND #6: Enlisting a 402(a) Trustee*
- *TREND #7: Removing the Statute of Limitations for Investment Liability*

- *TREND #8: Knowing Different Vendor Categories*

Below is an overview of these trends, as well as tips for how to best address them as a responsible retirement plan sponsor, steward, and fiduciary.

TREND #1: SHIFTING PRICING MODELS

The maturing investment market is driving down fees for investment advice and forcing a change in pricing from the old **asset-based approach** to more **plan-specific flat fee models**. Like most mature markets for products and services, investment services have now become part of a commodity-priced universe. One of the consequences of this new envi-

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Outsourcing ERISA retirement plan services has been around for decades, but recent industry developments have translated into new strategies for plan sponsors. Here are eight key trends and tips for 2015.

ronment is a pricing structure shift. Historically, pricing for investment services has been asset based. Now, many plan sponsors will see flat fee models from investment service providers that are customized for each plan. In prior years, an investment advisory contract might have advertised a 25 to 40 basis points charge that would be consistent for both current and prospective clients, regardless of size. Now, more investment firms are customizing their pricing to accommodate a particular plan's size and needs. A perhaps unintended consequence of this pricing shift is its effect on fiduciary responsibility. It actually is a good thing for plan sponsors in the world of fiduciary responsibility. Why? As pricing becomes based increasingly on *services rendered* rather than *plan size*, a more reasonable fee for that plan is often the result (and a "reasonable fee" is an explicit requirement under ERISA).

RECOMMENDATION: Plan sponsors should examine dollars being spent for each category of service and evaluate whether those dollars are growing disproportionately to the level of services they are receiving. Using the basis point rate alone as a point of comparison or for benchmarking can be deceiving, so measuring fees in dollars can help to make

a clear calculation. Excessive fees often lurk in the difficult-to-translate "basis point fee," so plan sponsors should not be afraid of asking their vendors to provide their fees in dollar figures.

TREND #2: HIRING INDEPENDENT PLAN ADMINISTRATORS

Plan sponsors are hiring firms that specialize in the *procurement of fiduciary support services* (see the Independent Plan Administrator category listed below) in response to the Department of Labor's aggressive enforcement of the vendor management rule found in ERISA Section 408(b)(2). (This section of the law requires a plan sponsor to regularly evaluate each plan vendor's fees to ensure they are reasonable.) Plan sponsors are hiring firms that specialize in this category of services to conduct an examination ensuring they are compliant with this new regulation.

RECOMMENDATION: When seeking a service provider that can assess vendor fee reasonableness, safety dictates that the provider does not deliver any other services that would be subject to the examination (such as investment advice or recordkeeping). Independence is the only way to ensure a wholly objective assessment

and vendor evaluation on behalf of the plan.

TREND #3: PASSING ON "MULTIPLE HAT" VENDORS

Outsourcing all of an ERISA plan's operational and fiduciary services to *sole source, or "multiple hat" vendors* is on the decline, driven by worries about how vendors' conflicted business models result in higher costs and concealed fees. This trend addresses, for instance, the insurance market for 401(k) services, where one large vendor may offer a 401(k) product and bundle all of the related services under the same umbrella, such as investment advice, participant training, and recordkeeping. The problem with this model has become apparent in numerous litigation cases and regulatory actions: bundled services can too easily hide excessive fees, which are explicitly forbidden under ERISA. Further troubling is the fact that the plan sponsor—not the vendor—is responsible for identifying and eradicating these fee discrepancies.

RECOMMENDATION: The best route for plan sponsors is not to work with a single vendor providing multiple services for the retirement plan. A U.S. Supreme Court opinion (*Metropolitan Life Insurance Company et. al. v. Glenn*) warned plan sponsors of the dangers of engaging "multiple hat vendors," as these

providers make the job of a plan sponsor all the more complex. If plan sponsors are entrenched with a sole source provider, they should be sure to be detailed and vigilant in unraveling each service (and corresponding fee) provided by that vendor for purposes of transparency and fee evaluation.

TREND #4: CREATING OUTCOME-BASED CONTRACTS

There has been an increase in **outcome-based contracts** for investment advice and recordkeeping-related services, as plan sponsors seek to develop more advanced risk management methods for their retirement plans. The previously mentioned change in fee structure (from asset-based models to flat fee pricing models) is on the rise because of these types of contracts, in which the vendor and plan sponsor collaborate on specific service-level goals within a definitive time period. These objectives later become part of the sponsor's vendor evaluation program. Plan sponsors are enrolling the help of their retirement plan vendors to define pre-set objectives in their respective areas of expertise in order to design a more sophisticated risk management program.

RECOMMENDATION: Plan sponsors should meet with their plan's vendors and ask each

vendor how they would like to be evaluated. Vendors' metrics then need to be more specific and in-depth than, for example, measuring the success of the program's investments (for an investment manager). Plan sponsors should enlist vendors' participation in the creation of a short list of key objectives that can be revisited and against which performance can be measured ongoing. These metrics should always be compared to industry standards to ensure they assess the most critical areas of vendor service and use the most effective metrics for those evaluations.

TREND #5: COLLABORATING WITH SERVICE PROVIDERS

To expand upon the previous trend, plan sponsors are seeking **collaborations with their service providers** across a number of areas in order to leverage knowledge sharing and optimize their oversight role. Collaboration and closer communication with vendors help plan sponsors gain a better awareness of how their vendors operate—including fee structures, affiliate relationships, processes and approach, measurement of outcomes and performance, and reporting mechanisms.

RECOMMENDATION: Plan sponsors should become fully aware of the Department of Labor's opinion and findings re-

lated to the state of the plan sponsor / vendor relationship. In the July 2010 issue of the *Federal Register*, the Department of Labor warned against the "information gap" that exists between plan sponsors and their retirement plan vendors, as it may "distort market outcomes" in vendors' favor. This information gap has been a frequent contributor to hidden and/or excessive service provider fees, and is one of the primary drivers behind plan sponsors' direction on this issue.

TREND #6: ENLISTING A 402(a) TRUSTEE

In the wake of the growing number of lawsuits alleging imprudence by plan sponsors, many sponsors are choosing not to manage their plans on their own, but rather to outsource the liability laden **ERISA Section 402(a) trustee** role to a specialized provider—not just an ERISA 3(16). This independent plan administrator can absorb all primary fiduciary responsibility from the plan sponsor, provided that the plan sponsor oversees this trustee role. As new 3(16) services increasingly flood the market, there is an important distinction to be made within the comprehensive plan administrator—or 402(a) trustee—role. While a recordkeeper may claim it provides 3(16) plan administrator services, the fine print often

reveals that only administrator “support services” are offered—which places the responsibility (and liability) directly back into the hands of the plan sponsor. While this may be a vendor’s clever marketing tactic, it denies any relationship to fiduciary status, instead it provides only support services to the 3(16). This second category in ERISA, section 402(a), alludes to the role of the plan sponsor, and clearly identifies the plan’s primary fiduciary. There is no such thing as 402(a) “support services”—therefore, a plan administrator who serves as a 402(a) trustee will accept all fiduciary duty on behalf of the plan sponsor—and cannot hide behind confusing marketing jargon.

RECOMMENDATION: If a plan sponsor is seeking to outsource the 3(16) plan administrator role, be sure the vendor provides the 402(a) trustee service *in addition to* the ERISA 3(16) to validate that the administrator fully encompasses the plan sponsor’s fiduciary responsibility.

TREND #7: REMOVING THE STATUTE OF LIMITATIONS FOR INVESTMENT LIABILITY

The U.S. Supreme Court’s recent decision in the *Tibble v. Edison* case has many plan sponsors outsourcing a thorough review of their fiduciary practices to an independent

plan administrator in order to adjust to the Court’s **removal of the statute of limitations** for investment liability. In this case, the court removed what was understood to be a six-year statute of limitations on investment fiduciary liability for plan sponsors. This has been an industry standard for some time, evidenced by many plan sponsors scheduling vendor RFPs around that timetable. The Supreme Court in this case determined that fiduciary responsibility is ongoing, so a calendar should not set parameters around determining fiduciary wrongdoing or misdeed. As could be predicted, this case result has left many within the industry surprised and slightly wary regarding how to proceed.

RECOMMENDATION: Plan sponsors should keep all documentation since the establishment of their retirement plan, if possible. They should also consider hiring an independent plan administrator to evaluate the organization’s fiduciary practices for continuity over the entire history of the plan (rather than just over a specific time frame). This vendor can help provide assurance that the plan and its management processes comply with ERISA and are in line with fiduciary best practices.

TREND #8: KNOWING DIFFERENT VENDOR CATEGORIES

Vendor categories remain **difficult to evaluate** due to the manner in which many service providers have introduced multiple services (some that conflict with a plan sponsor’s legal duty) over the past decade. These multiple services can make it difficult to evaluate vendors and assess their service quality and fee reasonableness.

RECOMMENDATION: It is important to be mindful of the precedent that the aforementioned Supreme Court case set in regards to the “multiple hat” vendor. Plan sponsors should consider asking an independent fiduciary firm to examine their specific situation and vendor contracts. As a brief overview, the Fiduciary Supply Management Association (FSMA) defines the major vendor categories as follows:

- **Investment Advice: Plan Sponsor**—Provides advice on investments to a retirement plan’s Plan Administrator that is comprehensive in scope, is ongoing, and for which compensation is paid for such advice.
- **Investment Manager: Plan Sponsor**—Accepts in writing complete discretionary authority for se-

lecting, monitoring, and, as needed, changing a qualified plan's investment options.

- **Investment Advice: Participants**—Investment consultants (whether licensed as Registered Investment Advisors or Registered Representatives of a securities broker/dealer firm) that provide education, training, and/or investment counsel to retirement plan participants.
- **Third Party Administration**—Ministerial role that includes an annual testing of a retirement plan's compliance with the Internal Revenue Code and preparation of Form 5500.
- **Recordkeeping**—Processes the plan's trading and cashing transactions

that occur in plan participants' accounts, and performs all of the participant reporting, plan usage analysis, and communication with the plan's custodian.

- **Turnkey (also classified as "multiple hat")**—Offers a collection of services that can be sold to any retirement plan sponsor as a completed program, which could include investment advice, recordkeeping, and third party administration.
- **Independent Plan Administrator (only those that serve as both an ERISA Sections 402(a) and 3(16) fiduciary)**—Has the highest level of fiduciary responsibility for a qualified benefit plan's opera-

tion, possessing discretionary authority over the management and administration of the plan (primarily the operation of the plan).

Each of these eight trends has one common denominator: they all involve coordinating with at least one retirement plan service provider. The complexity of the relationship between plan sponsors and their vendors is the single-most pressing issue in the retirement plan management industry today. If plan sponsors have questions about their current retirement plan vendors, or are seeking a new partnership to evaluate current vendor relationships, they may find information and additional resources at FSMA's website, www.fiduciarysma.org.