The Plan Sponsor's Guide to Delegating, Part II: Recordkeeping Made Simple

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An ERISA recordkeeper is one of the most heavily relied-upon experts within a plan sponsor's vendor arsenal. Often, however, there is confusion about the breadth of a recordkeeper's responsibilities, as well as what to look for in selecting the right recordkeeper for a given retirement plan. Here, a breakdown of the recordkeeping role, its significance to plan sponsors, and how to maximize efficiencies with this key fiduciary partner.

WHAT IS A RECORDKEEPER?

A recordkeeper is critical to the retirement plan management process, and can be a true asset for plan sponsor fiduciaries in ensuring their retirement plans' success. Acting as the liaison between plan participants and their investment transactions, a recordkeeping service provider's responsibilities include:

- Accepting transaction requests from retirement plan employees, plan sponsors, and financial advisors;
- Processing and allocating contributions; and
- Updating participant "records" upon settlement of transactions.

Not to be confused with a third party administrator, a recordkeeper has very little involvement in administering the retirement plan. Rather, the recordkeeper is a scribe who writes where a participant's money should be allocated under the participant's direction. Because the recordkeeper controls the ease and efficiency with which plan participants can interact with and make changes to their investments, the effectiveness of the recordkeeper is essential in gaining plan participant satisfaction with the overall retirement plan management process. A good recordkeeper can help to build a satisfied employee community, while an underperforming recordkeeper can cause unnecessary issues to brew between a plan sponsor and its participants.

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SIMILAR BUT DISTINCTIVE ROLES: RECORDKEEPER VS. TPA

The responsibilities of a recordkeeper are often confused with those of another closely related fiduciary support vendor—the third party administrator. While a recordkeeper acts as the director of participants' allocations, an administrative services vendor (or a third party administrator "TPA") is the overseer of these transactions. Incidentally, a TPA should not be confused with the Plan Administrator, which is a role assigned specifically to plan sponsors by ERISA. The TPA ensures that a retirement plan's activity is compliant with certain features of the plan's governing ERISA documents and tax laws. A TPA's typical responsibilities include:

- Filing government forms;
- Performing compliance testing of participants' contributions against the Internal Revenue Code;
- Designing ERISA plans;
- Preparing plan documents; and
- Consulting on plan design issues.

The most noteworthy difference between a recordkeeper and TPA? The recordkeeper has direct access to participants, while the TPA primarily interacts with the plan sponsor in ensuring the plan sponsor's compliance with federal reporting requirements. Hence, the importance of engaging the right recordkeeper to effectively communicate with and efficiently transfer data for plan participants is paramount.

DELVING INTO THE RECORDKEEPING ROLE: THE TRADING TRANSACTION PROCESS

A closer look at the investment transaction process within the fiduciary supply chain helps to define the integral yet different roles of the recordkeeper and TPA. Diagram A illustrates the interaction between the recordkeeper, TPA, and plan participants in a typical investment transactions process.

Diagram A.

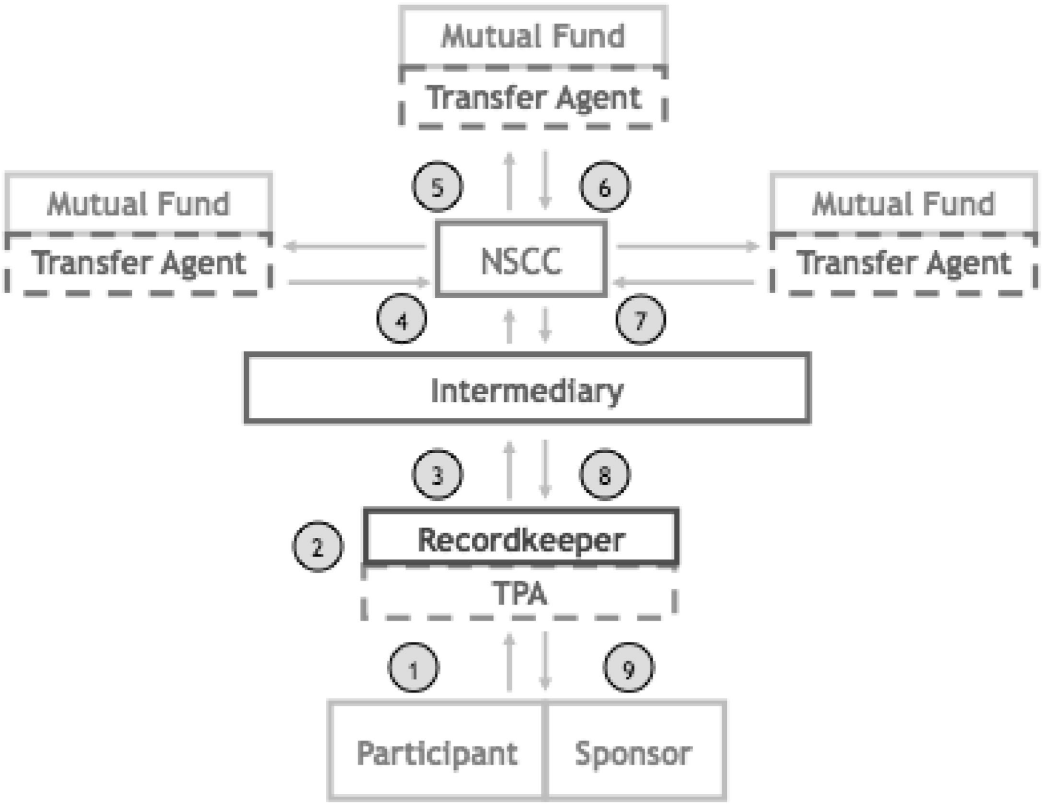

Diagram A. Definitions

Plan Sponsor:
An employer and fiduciary that "sponsors" and is responsible for a retirement plan.

Plan Participant:
The underlying individual shareholder in an ERISA retirement plan.

Intermediary:
An entity that handles cash and settlements for a Recordkeeper; also known as a trustee, custodian, or trading agent.

National Securities Clearing Corporation ("NSCC"):
The centralized, national trade clearance and settlement platform used to transmit trades to mutual fund companies.

Transfer Agent:
A person who issues, converts, registers, and monitors investment securities.

As demonstrated in Diagram A, the trading transaction process flow is as follows:

1. Transactions are initiated by both **plan sponsor** and **participants**.

2. The **recordkeeper** processes transaction requests (while the **TPA** ensures compliance with tax laws and plan documents).

3. The **recordkeeper** submits trades to a **custodian/trade agent**.

4. The **custodian/trade agent** submits trades to the **NSCC**.

5. The **NSCC** submits trades to the **transfer agent** for the fund companies.

6. The **funds/transfer agents** confirm the transaction to the **NSCC**.

7. The **NSCC** remits the confirmation to the **intermediary**.

8. The **intermediary** settles the trade and confirms the trade with the **recordkeeper**.

9. The **recordkeeper** updates participant accounts and makes information available at **plan and participant** level.

Again, the notable distinction here is that the recordkeeper has several direct touch points with plan participants—so selecting a recordkeeper that aligns with the specific plan participants' needs and preferences is key in bolstering a plan sponsor's overall fiduciary approach.

TWO TYPES OF RECORDKEEPERS

There are several factors plan sponsors should consider when selecting and/or evaluating the effectiveness of a recordkeeper. First and foremost, there are two primary categories of recordkeepers:

- Independent recordkeepers
- Investment company-affiliated recordkeepers.

Independent recordkeepers have no ownership association with any investment company or investment product. The nature of their independence can make a plan sponsor's job of monitoring processes and outcomes easier, as there is no lack of transparency regarding where the recordkeeper's primary loyalty resides. Recordkeepers affiliated with investment companies can present a more difficult due diligence process for plan sponsors. Because they are not exclusively focused on the recordkeeping function, the depth and breadth of their services should be thoroughly evaluated. Further, it can be harder for plan sponsors to fully understand or dissect the affiliated recordkeeper's processes, as their approach related to investment products or systems can often be dictated by their associated investment company.

Most often, plan sponsors will find more ease in assessing the approach and practices of an independent recordkeeper. However, if plan sponsors are already working with a bundled recordkeeping provider, there are some key evaluation metrics they can utilize to determine their current recordkeeper's value to their plan and participants.

RECORDKEEPING MADE SIMPLE: KEY FACTORS TO CONSIDER

Whether plan sponsors contemplate working with an independent or affiliated recordkeeping service provider, there are three key areas to evaluate to ensure the recordkeeper is aligned with industry best practices. The three areas that are crucial in assessing a potential recordkeeper include:

1. Custodian Market Interaction
2. Plan Participant Benefits
3. IT Sophistication.

Let's take a closer look at these three areas, and how they impact the potential value of the recordkeeping role.

Custodian Market Interaction

This first prong of recordkeeper analysis is closely tied with the third area we will address related to IT sophistication. The custodian (or intermediary) market with which the recordkeeper interacts is extremely sophisticated with respect to information technology. For fiduciaries in the process of selecting and monitoring vendors under ERISA, they want to choose service providers who are transparent regarding their fees, services, and value. If a recordkeeper's IT systems are less sophisticated than that of the custodian with whom a plan sponsor would like to partner, this causes misalignment between the vendors in an area that needs to work perfectly in sync. Hence, evaluating the universe of custodians with whom the recordkeeper interacts is an accurate gauge for whether the recordkeeper will be a seamless player within the greater fiduciary supply chain. If the recordkeeper only has a small number of custodians with which it partners, this can be a hindrance to the plan sponsor wishing to maximize vendor options. Ensuring that a recordkeeper maintains a relatively large list of custodian partners is an effective way for fiduciaries to keep options open for selecting and working with ideal vendors in each of their respective fiduciary disciplines.

Plan Participant Benefits

This is perhaps the most important criterion to consider when evaluating recordkeeping partners. As referenced earlier, the recordkeeping function is unique in its access to and interaction with plan participants. While it serves a recipient role in transferring plan participants' investment transactions, the recordkeeper is also responsible for maintaining real-time communications and web-based services that allow participants to easily access and understand their current investment information. Increasingly, a web-based platform is the primary vehicle used by recordkeepers to provide this robust suite of plan participant resources. The importance of this function can be illustrated when web-based recordkeeping services do not align with participants' needs. For example, if a recordkeeper offered separate platforms for a participant's 401k plan and her defined benefit plan, then the participant would not be able to view her entire portfolio at a glance. This inconvenience caused to the plan participant would be detrimental to a plan sponsor—so it is recommended that the plan sponsor examine the recordkeeper's participant resources in advance of engaging them as a fiduciary partner to avoid a similar scenario.

IT Sophistication

Both of the prior evaluation factors are tied closely to the third key factor in selecting the right recordkeeper: IT sophistication. Ensuring that the recordkeeper's platform meets both the needs of the custodian and the plan participants is a critical contributing factor to a retirement plan's overall success. So the question becomes, how does a plan sponsor determine whether a recordkeeper's IT systems are sufficient? The answer lies in the recordkeeper's independent attestation of its trading and cashiering practices. Recordkeeper attestation is offered through the American Institute of CPAs ("AICPA"), the specific name for which is the Statement on Standards for Attestation Engagements No. 16 ("SSAE 16"). This attestation provides assurance to plan sponsors, custodians, and mutual fund companies that recordkeepers are staying abreast of key developmental milestones, and that they meet minimum industry standards for IT functionality and capabilities. An assessment program that focuses on the operational practices of recordkeepers and TPAs is offered by the American Institute of Pension Professionals and Actuaries ("ASPPA"). That program is administered by the Centre for Fiduciary Excellence.

FIDUCIARY STATUS OF RECORDKEEPERS AND TPAS

As providers of only ministerial services, recordkeepers and TPAs do not bear a fiduciary responsibility to ERISA qualified plans. According to a case decided in U.S. District Court in Houston, Texas, however, they may acquire ERISA fiduciary status if they perform a fiduciary function. For that reason, it is vital that a plan sponsor carefully monitors its recordkeeper and TPA just as carefully as it monitors its mutual fund providers and investment advisor. In order to avoid unacceptable conflicts of interest that may lead a plan sponsor wittingly into an ERISA prohibited transaction, recordkeepers and TPAs should not be engaged to perform any other role in the fiduciary supply chain. Examples of those conflicting roles include investment advisor, investment manager, custodian, and ERISA Section 3(16) plan administrator.

CONCLUSION

Of all of the service providers in the retirement plan industry, recordkeepers and TPAs are the only two types of vendors that are not at all regulated by the federal government. And yet, many plan sponsors rely on recordkeepers and TPAs as their go-to resource for fiduciary support in vital areas such as participant account management and investment transaction process efficiency. What's more, many plan sponsors erroneously think that their TPA is their plan's fiduciary. What does the lack of federal regulation on recordkeepers and TPAs mean for plan sponsors? Given recordkeepers' significant influence on participant satisfaction, coupled with their centralized role as an advisor to plan sponsors, plan sponsors have an added incentive to perform the needed due diligence in evaluating their recordkeeper's and TPA's capabilities and service fit. By following the tips provided herein, plan sponsors can feel at ease that they are choosing recordkeeping partners that will be effective in their role, align with participant and other vendors' needs, and lessen their overall fiduciary burden.