The Anti-Bundled Bundled Solution: How a Turnkey Open Architecture Approach Changes the Game for Plan Sponsors

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AN EMERGING RETIREMENT PLAN SERVICES MODEL

Many retirement plan sponsors hire vendors that bundle several services, meaning that a single vendor wears multiple hats. An example is a vendor that provides recordkeeping, third party administration, custodian, and investment management services all under one contract, often through affiliates controlled by the main vendor. Payroll companies, recordkeepers, third party administrators, mutual funds, insurance companies and commercial banks promote an "ease of use" advantage in their bundled programs in order to entice 401(k) fiduciaries to become clients. For smaller 401(k) plans, plan sponsors are, naturally, drawn to the appeal of an employee benefit program that is easy to operate. It is not surprising, therefore, that a very large number of small to medium-sized plans have engaged bundled service providers.

But are bundled arrangements delivering enough value to offset the excessive fee risk that their programs present to both plan fiduciaries and plan participants? Further, in light of the burden imposed on all 401(k) plan sponsors by the new fee disclosure regulations, do multiple hat vendors actually set up a plan sponsor fiduciary for regulatory ambush? This article will explore the dangers inherent in traditionally bundled retirement plan services, and the amazingly similar—yet ERISA-compliant—approach that is redefining the fiduciary landscape.

THE HISTORY OF BUNDLED RETIREMENT PLAN SERVICES

The retirement plan market has a longtime history of offering bundled services to companies that sponsor benefit plans for their employees. It is an attractive, "one-stop shop" premise for plan sponsor organizations (and specifically, for those individual executive fiduciaries that are busy with other aspects of the business and need to make decisions quickly). But, perhaps a lesser obvious community that has benefitted from bundled arrangements is the service provider market itself. Let's take a quick look at how this phenomenon has developed over time.

An initial benefit for retirement plan vendors under the bundled service umbrella was that the vendor could be the single point of contact for all plan decisions—which provided the vendor enviable power and autonomy. (From a plan sponsor perspective, this meant much trust was being placed in a single vendor to do the right thing on behalf of the retirement plan—and, most importantly,

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the plan's participants.) As vendors became more sophisticated in their trade and plan sponsors continued to be burdened by a plethora of other issues related to their business, the DOL-termed fiduciary "information gap" expanded between vendors and their plan sponsors.

Soon, a murkier bundled services scenario emerged. The shrewd bundled service provider now saw that he could leverage this clear "information gap advantage" to his benefit. So, for the unethical (or, in some cases, unknowing) bundled service retirement plan vendor, this realization began manifesting itself in several ways: 1) ensuring proprietary funds were part of the plans' investment line-up so that he collected higher fees, 2) hiding his transaction fees in lengthy, esoteric summary reports to the plan sponsor, and/or 3) being complacent in his service approach while charging fees that were disproportionately high for the value he was providing. As plan sponsors and plan participants began to suffer due to these increasingly prevalent vendor practices, the DOL finally was forced to intervene.

THE IMPACT OF ERISA'S FEE DISCLOSURE RULE

On July 16, 2011, the DOL put into effect a new mandate under ERISA, entitled regulation 408(b)(2) (also commonly known as the fee disclosure rule). The purpose of this new regulation was to close the "information gap," by ensuring that retirement plan vendors were charging fees that were "reasonable" as compared to the services they were providing to their retirement plan sponsor clients. The challenge for plan sponsors under this new arrangement was to learn how to discern which vendors' fees were "reasonable," and which were considered "excessive," as they were being directed to do by the DOL.

However, since no precedent was set regarding *how* to measure the elusive term of "fee reasonableness," many plan sponsors still relied on their vendors to provide the appropriate disclosures and adopt the transparency that the DOL was intending with this new rule. Even today, this reliance on vendors remains a trend, as plan sponsors are trying to do the best they can with limited resources and a lack of deep knowledge around the complex arena of fiduciary duty. But with 408(b)(2), the onus now lies with the plan sponsor to measure their vendors' fee reasonableness, and they face regulatory enforcement action as a result of inaction.

For plan sponsors, until now, a single point of contact with a bundled vendor has been, seemingly, the easiest solution for managing their retirement plan. But today, a revolutionary open architecture solution threatens to displace this reigning fiduciary model by offering the same ease of use—but with a whole host of additional (ERISA-compliant) benefits.

A REVOLUTIONARY SOLUTION: TURNKEY OPEN ARCHITECTURE

The bundled solution offers an undeniable benefit to plan sponsors: a one-stop approach that features a single point of contact for all of their fiduciary support needs. But the risks of this method heavily outweigh the positive: Hidden conflicts of interest, excessive fee arrangements, and service levels that are difficult to evaluate can translate into more of a headache than a help for plan sponsor fiduciaries. And in the post-408(b)(2) era, this bundled provider approach is even more dangerous, with plan sponsors and vendors facing the consequences of unprecedented liability.

According to the DOL, penalties for plan sponsors entangled with vendors that do not meet post-fee disclosure standards have averaged a staggering $450,000 per plan. And it's not just low-profile vendors that are being named in fiduciary liability lawsuits—most recently, J.P.

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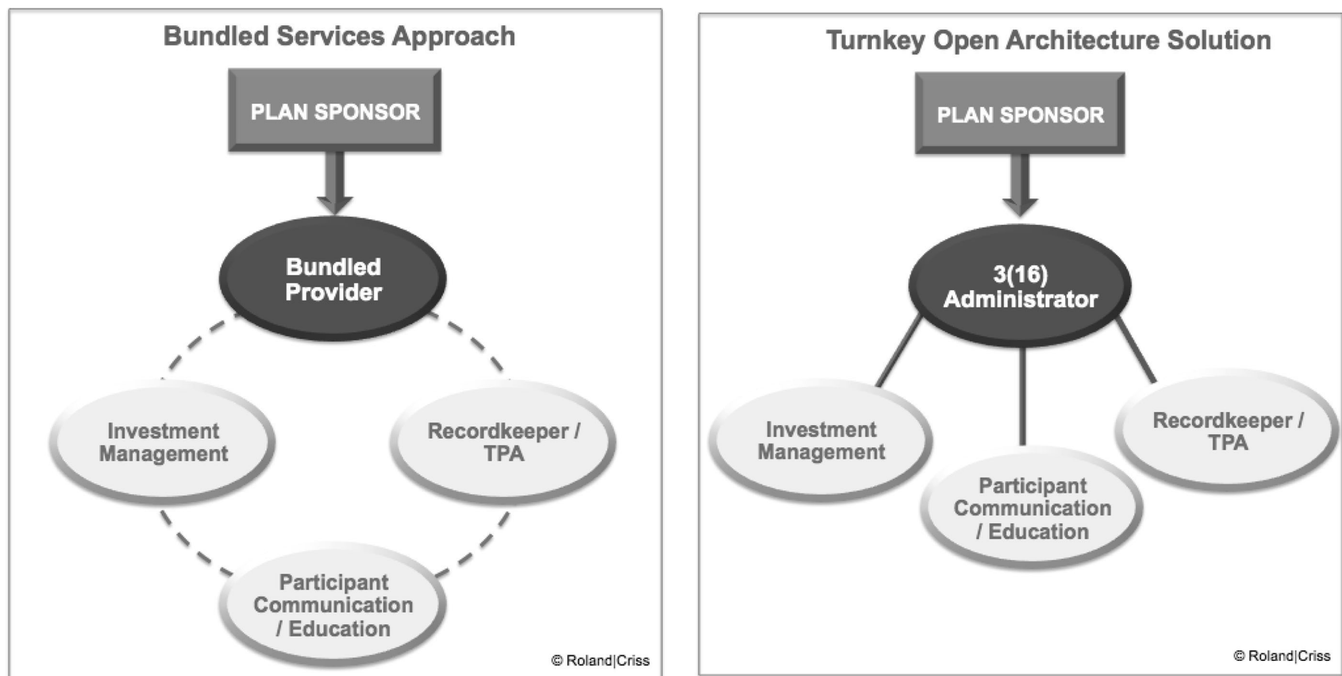
Morgan Chase, Fidelity Asset Management Company, and Hewitt Associates have been involved in fiduciary breaches of duty lawsuit settlements. So drawing the line between the trustworthy vendor and the self-serving provider becomes even more blurred for the well-intentioned plan sponsor.

Luckily, a new fiduciary model has emerged that offers the same single point of contact (read: no-hassle approach) for plan sponsors, but with a convenient (and now necessary) post-fee disclosure compliance process. An illustration (Figure A, below) helps to demonstrate the key differences between the old bundled approach and the new turnkey open architecture solution.

Figure A. Bundled Services Approach vs. Turnkey Open Architecture Solution



Following are the two similarities between these approaches:

- The plan sponsor retains a **single point of contact** for fiduciary responsibility, so the bundled "one-stop" advantage is still in play.
- The plan sponsor can retain the use of the **same service provider(s)** that have been utilized historically.

This means that the way a retirement plan sponsor fiduciary *experiences* the management of her plan should, in many ways, look and feel the same. The value in the turnkey open architecture approach lies within its structure, as it quietly and effectively eliminates the risks inherent in a bundled service provider scenario. In the turnkey approach, an independent 3(16) Administrator (not a firm that provides other services such as third party administration, recordkeeping, or investment advice) legally takes over the fiduciary responsibility on behalf of the plan sponsor, which includes ensuring that the "fee reasonableness" mandate is being met by all of the plan sponsor's retirement plan vendors. (If the prior vendor is a bundled provider, the 3(16) will simply ensure that the reporting and fees of each of the provider's various services meet the new fee disclosure standards.)

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REMINDER: WHAT IS A 3(16) ADMINISTRATOR?

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A 3(16) Administrator (or Plan Administrator) is the primary person or persons responsible for managing the day-to-day operation of a retirement plan. If a Plan Administrator is not named in the plan document, this role defaults to the plan sponsor. Under ERISA, a plan sponsor may appoint an independent fiduciary to serve as the ERISA section 3(16) Plan Administrator on behalf of their plan.

So, here are the primary differences between these approaches:

- **Fiduciary Role:** The bundled approach is an **abdication** of responsibility by the plan sponsor, which means that while the plan sponsor has little to no control over his plan, he still retains legal fiduciary liability for the decisions made by his primary vendor. The turnkey approach is a **delegation** of fiduciary responsibility to the outsourced 3(16) Administrator under ERISA, which virtually eliminates fiduciary liability for the plan sponsor, while keeping him in an informed position of control over plan decisions.

- **Transparency:** The turnkey approach ensures transparency in all vendor fees, which, in most all cases, leads to **lower costs** and **better service** for the plan sponsor.

- **Vendor Arrangements:** Unlike the bundled approach in which one multiple-hat provider attempts to sweep a number of services under the same service arrangement, the turnkey solution separates service arrangements so that they are **easier to understand** and the vendors are **easier to manage**. This also means eliminating vendor conflicts of interest that could have previously motivated the vendor to make certain investment decisions based on his own (or his company's) interest.

- **ERISA Compliance:** Perhaps the most important difference between the two approaches is that the turnkey open architecture solution **satisfies regulatory mandates** under the new 408(b)(2) disclosure rules. With a designated,

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independent 3(16) Administrator at the helm, the legal burden of evaluating and managing of vendors' arrangements is removed from the plan sponsor and transferred to the 3(16), who claims full fiduciary responsibility for the plan.

By addressing all of the above critical factors, the turnkey open architecture approach crafts an ideal fiduciary solution focused on serving the plan sponsor's and the plan participant's best interests—not the interests of the vendor. Under ERISA, and specifically, now under 408(b)(2), the turnkey open architecture plan aligns with fiduciary best practices, and enables plan sponsors peace of mind about mitigating their fiduciary liability and fulfilling their day-to-day retirement plan responsibilities.

CONCLUSION

In an increasingly procurement-driven corporate culture, executives are becoming more involved in the details of how, why and when their companies solicit outside services across a range of disciplines. The fiduciary supply chain is not much unlike many others in the corporate environment—it requires a level of oversight, evaluation of the right partners, and an outlined process to ensure each link in the supply chain integrates seamlessly with the overall strategy. The easiest answer to fiduciary supply chain management in the past has been the bundled service provider arrangement. Now, in light of the new fee disclosure rules, plan sponsors have another—equally simple—choice, that also complies with these recent regulatory mandates. The turnkey open architecture solution places plan sponsors in the best position, as they are 1) able to focus on those executive-level issues of most import at their respective organizations, 2) confident their plan participants are gaining the benefit of a fiduciary best-practices model, and 3) protected from fiduciary liability. The turnkey open architecture solution is such a seamless transition to a best-practice model, the fiduciary community might even forget it's not bundled.

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