THE EXCELLENT FIDUCIARY

The Plan Sponsor's Guide to Delegating, Part III: Outsourcing It All—The 3(16) Plan Administrator

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Outsourcing critical parts of the fiduciary function, and even the entire role, is a rapidly growing trend within the retirement plan community. Indeed, section 3(16) of ERISA encourages this decision, describing the primary outsourced provider as the "Plan Administrator." Because the Plan Administrator holds the greatest amount of responsibility for a retirement plan, retirement plan sponsors need clear guidance on how to delineate between authentic Plan Administrators, and those that possess characteristics that can undermine a sponsor's risk management intentions.

What Can Delegation Mean to Retirement Plan Sponsors?

In this series, entitled, "The Plan Sponsor's Guide to Delegating," we have provided retirement plan sponsors ("Plan Sponsors") with an overview of why and how they should hire several key members of the fiduciary supply chain. The two provider categories discussed thus far have been investment consultants that offer their services as Investment Managers as that role is defined in Section 3(38) of the Employee Retirement Income Security Act ("ERISA") and firms that provide ministerial services (they include recordkeepers and third party administrators). Both of these categories represent roles that are instrumental to the effective management of a retirement plan, as articulated by ERISA. By outsourcing these responsibilities to well-qualified experts, Plan Sponsors put themselves in an ideal position of complying with ERISA, minimizing their legal risk, and optimizing their retirement plans for the benefit of their plan participants.

While investment consulting and ministerial support are essential parts of the fiduciary function, they are also very specialized roles: the Investment Manager selects investments for the retirement plan, and recordkeepers process contributions of plan participants. One provider role, however, encompasses every facet of fiduciary duty: the 3(16) Plan Administrator. This article will illuminate why selecting the

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right 3(16) Plan Administrator can be the ultimate delegation decision for Plan Sponsors—unburdening them from some of ERISA's most difficult fiduciary tasks.

A REVIEW: THE PLAN SPONSOR ROLE

A quick review of the entirety of Plan Sponsor responsibility will help in understanding the pivotal role that a 3(16) Plan Administrator plays in managing the Plan Sponsor's fiduciary function. *Fiduciaries*, according to ERISA, are individuals who have been given by their employers the responsibility to administer their organizations' retirement plans and invest their plans' assets. Under the wide umbrella of the Plan Sponsor's fiduciary responsibility exist specific duties, categorized under four main disciplines: **Governance**, **Administration**, **Investments**, and **Controls**.

The Plan Administrator, which is the supreme fiduciary, acting on behalf of the Plan Sponsor, bears significant personal liability for decisions made within each of these disciplines. A general description of each discipline appears below:

- **Governance**—The establishment of management systems and personnel;
- **Administration**—The day-to-day maintenance of fiduciary systems;
- **Investments**—The knowledge of the financial investment process and nomenclature; and
- **Controls**—The measurement of success against a standard of conduct.

Because each of the disciplines requires specific expertise and significant time to execute properly, ERISA encourages fiduciaries to obtain help in satisfying these duties by delegating certain of the responsibilities to qualified third parties. Until recently, the **Investments** and **Administration** functions required to properly manage an ERISA plan are the disciplines that received most of the attention for delegation. That, however, is changing. While investment consulting, recordkeeping, and third party administration remain the dominant delegated services, many Plan Sponsors are now turning to independent Plan Administrators to ease the weight of their legal duties. Why? Because an independent Plan Administrator can be the secret weapon to ensuring **all** disciplines of fiduciary duty are performed correctly under ERISA, including the daunting task of ensuring fiduciary supply chain vendors are selected and managed prudently.

WHAT IS A 3(16) PLAN ADMINISTRATOR?

Section 3(16) of ERISA describes the role of the Plan Administrator, not to be confused with a "Pension Administrator" or a "Third Party Administrator." The primary duties of a Plan Administrator include the following:

- **Vendor Management:** Hire and monitor vendors that provide services to their ERISA qualified plan;
- **Filing Accuracy:** Verify that all filings with the federal government are made on time;
- **ERISA Compliance:** Ensure compliance with all available exemptions from prohibited transactions within ERISA;
- **Disclosure Distribution:** Deliver various disclosures to plan participants; and
- **Plan Oversight:** Manage the plan in accordance with the plan's policies as defined in such documents as a trust agreement, investment policy statement, and conflicts of interest policy.

For practical as well as cultural reasons, Plan Sponsors historically have reserved the above duties for themselves. In prior years, many Plan Sponsors retained these responsibilities due to a general lack of knowledge in the Plan Sponsor community regarding the com-

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plexity of their fiduciary duty. Now, as Plan Sponsors become more educated about the risks associated with their role, increasing numbers are appointing an independent ERISA 3(16) Plan Administrator to either support the plan's in-house fiduciary that fills that chair, or to serve in a fully outsourced role—responsible for the general oversight and management of their plan and its vendors.

WHY SHOULD PLAN SPONSORS HIRE ERISA INDEPENDENT 3(16) PLAN ADMINISTRATORS?

Maintaining a qualified cadre of service providers in today's retirement plan market is one of the three legally most risky activities for Plan Sponsors. The other two include conformance to the plan's trust rules, and execution of a funding policy [as described in ERISA Section 402(b)(1)]. These activities present a major challenge to most executives who have been charged by their employer to serve as the Plan Administrator. These C-suite leaders, by trade, lack the training and specialized experience necessary for the job of vendor management, fiduciary process management, and investment decision making management. It is not surprising, therefore, that the ability to discharge some or all of those activities to a qualified, unbiased independent Plan Administrator makes sense for a large percentage of this executive population.

Engaging the services of an independent 3(16) Plan Administrator eliminates a Plan Sponsor's need to possess expertise and credentials in connection with selecting vendors in the investment, recordkeeping, and custodian sectors. Once engaged, the independent Plan Administrator takes over that role, both functionally and legally. Consequently, the Plan Sponsor is freed from the burden of performing the four fiduciary disciplines at a high level of competency—and is only left with ERISA's requirement to monitor the Plan Administrator, usually on an annual basis. In sum, the 3(16) Plan Administrator can be a Plan Sponsor's best (outsourced) friend—if the right one is selected.

TEN TRAITS OF ELITE ERISA 3(16) PLAN ADMINISTRATORS

In the new era of accountability being enforced by the U.S. Department of Labor ("DOL"), buyers of fiduciary support services want assurance that the vendors in their supply chains are trustworthy. That holds true for all vendors, including investment consultants, recordkeepers, third party administrators, money managers, and custodians. In order to help Plan Sponsors evaluate and choose a trustworthy ERISA 3(16) Plan Administrator, the following is a list of traits embodied by the best providers in the industry:

1. Communicate with clients in **jargon-free language**;
2. Make **reconciliation of fees** for services easy;
3. **Do not overreach** on claims of fiduciary status;
4. **Are transparent** about all sources of income;
5. **Do not have affiliate businesses** that provide services to retirement plans;
6. **Update contracts** as services change;
7. Deliver relevant, **succinct status reports**;
8. **Do not provide any other services** to retirement plans such as investments or investment advice, recordkeeping, and third party administration;
9. Facilitate **formal fiduciary training** for clients; and
10. Obtain a **regular independent review** of the client's fiduciary support systems and practices.

When assessing potential 3(16) Plan Administrator candidates,

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it is perfectly appropriate to use this list as a questionnaire, asking each Plan Administrator provider to validate or address its firm's approach to these issues. If a Plan Administrator claims not to adhere to one of the above behaviors, that should prompt a Plan Sponsor to determine whether there are further underlying issues. The biggest culprit that thwarts a successful Plan Administrator relationship is the existence of conflicts of interest. Simply stated, a provider offering multiple services under the same umbrella can more easily hide an excessive fee structure. So, this checklist can be used as a preliminary gauge of a Plan Administrator's quality. If a red flag arises on any of the "top ten" characteristics, delving a bit deeper into the issue is recommended. Careful evaluation practices prior to hiring a Plan Administrator can ensure that this critical outsourced provider possesses the trustworthiness that every Plan Sponsor—and plan participant—deserves.

THE ARGUMENT FOR A 3(16) PLAN ADMINISTRATOR, NOW

The DOL's pace of enforcement has produced staggering numbers. Exhibit A, below, illustrates some of these trends. For example, in fiscal year 2011, the Employee Benefits Security Administration ("EBSA"), which is the enforcement arm of the DOL, collected over $1.3 billion in fines and asset recovery from ERISA qualified Plan Sponsors. More than 74% of its audits produced economic penalties for the plans it audited.

Many of the causes behind these fines and sanctions are repeated year after year, and include: excessive fees by service providers, provider conflicts of interest, and lack of proper plan oversight. These recurring issues highlight Plan Sponsors' struggle to adequately perform complex fiduciary duties on their own—and demonstrate the need to outsource these critical responsibilities to an independent, qualified 3(16) Plan Administrator.

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