Outsourcing 401(k) Fiduciary Risk;

What is right for you?

A white paper by R.L. "Dick" Billings, RF, CPC, CEBS, ERPA

June 2020

dick.billings@fiduciarywise.com

Direct - 602-975-0282

Fiduciary Wise

fiduciarywise.com

888-402-WISE (9473)

Summary

Sponsors of retirement plans, particularly 401(k)s and ERISA-403(b)s, have for years been barraged with information about their fiduciary duties. Many hear about the burden of sponsoring and maintaining these types of plans. The word "fiduciary" is thrown around as a sales tactic, as a scare tactic. Fiduciary risk is indeed a fact of retirement plan life. This fact contributes to Plan Sponsors ongoing fear that, whatever it is they are supposed to be doing, they are either not doing it at all, or they are not doing it right; and the feds are right around the corner waiting to get them.

This paper examines how relatively simple it is to insulate one from most fiduciary risk; and more importantly, *"do the right thing"* for the Plan's underlying participants**.** Such efforts make the Plan Sponsor safer, the participants happier, and quite frequently, reduce overall plan costs**.**

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What an Employer/Plan Sponsor can do to reduce fiduciary risk

Before proceeding further, one must put the word "fiduciary" in proper context. ERISA[1] says that every 401(k), and ERISA 403(b) Plan, must have a *"Named Fiduciary".* The Named Fiduciary is, as former President Harry S. Truman's Oval Office desk sign read, *"The Buck Stops Here"* person. If the Plan document(s) fail to name an actual person (or persons) as the Named Fiduciary, it defaults to the Employer/Plan Sponsor. Unfortunately, most Employer/Plan Sponsors are totally unaware that their plan document has most likely defaulted this important fiduciary responsibility to them.

A fiduciary, especially a Named Fiduciary, is the person or persons assigned the *"authority to* ***control and manage*** (emphasis added)*. the operation and administration of the plan"* [2] The Named Fiduciary must, by law, act *"solely in the interest of plan participants and beneficiaries…with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man* (person) *acting in a like capacity and familiar with such matters would use…)"* [3]*.* This is sometimes referred to the *prudent expert* rule.

In other words, a Named Fiduciary is someone who has the responsibility of *running the plan*. Named Fiduciaries must act prudently; that is, carefully exercise the care and skill of someone who knows what they are doing . Finally, Named Fiduciaries must operate their Plan according to its written terms and all applicable Federal Regulations.

Service providers who accept both 402(a) AND 3(16) responsibilities take most of the legal burdens and liability off the shoulders of Employers/Plan Sponsors. This is less true if only 3(16) responsibilities are accepted by outside experts.

Enter the "independent expert outside administrator", commonly called a *402 Named Fiduciary* (as defined under ERISA §402(a)) and *Plan Administrator* (as defined under ERISA §3(16)). Service providers who accept both 402(a) **AND** 3(16) responsibilities take most of the legal burdens and liability off the shoulders of Employers/Plan Sponsors. This is less true if only 3(16) responsibilities are accepted by outside experts.

An analogy – owner has a growing and successful business. This owner is so busy each and every day that virtually no time is available to oversee production, the sales department, or the human resources people. What would a typical busy business owner do? He or she would hire a CEO; someone qualified to oversee the company's day-to-day affairs. This now allows the owner to concentrate on growing the business. The owner still owns the company and still retains ultimate control; but otherwise, the CEO takes many, many responsibilities off the owner's shoulders. One other thing – the hiring of the CEO doesn't reduce the company's workforce by replacing supervisors; or the head of HR. Rather, the CEO, regarding day-to-day responsibilities, fires only the owner; because that is what the owner desired.

This is exactly how it goes with the hiring of a professional outside 402 Named Fiduciary. The Named Fiduciary takes on the day-to-day responsibilities of running the 401(k) or ERISA 403(b) Plan, allowing the owner to concentrate on running his or her business. The outside Named Fiduciary does not replace any other retirement plan vendor; just the owner. Further, if the outside Named Fiduciary is truly independent, said expert firm will not present a Conflict-of-Interest by offering ancillary retirement plans services outside of the 402 and 3(16) services (e.g. investment advisory services, TPA services, recordkeeping, etc.).

What ERISA says about 402 "Named Fiduciaries" and 3(16) "Plan Administrators"

These two respective ERISA Sections are pretty short. So, we will let you see what they say exactly:

ERISA §402 "Named Fiduciary"
"Every employee benefit plan shall be established and maintained pursuant to a written instrument. Such instrument shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage (emphasis added) the operation and administration of the plan." (29 U.S. Code §1102(a)(1))

ERISA §3(16) "Plan Administrator"
"…(i) The person so designated by the terms of the instrument under which the plan is operated; (ii) if an administrator is not so designated, the plan sponsor (emphasis added); (iii) In the case of a plan for which an administrator is not designated and the plan sponsor cannot be identified, such other persons as the Secretary may by regulation prescribe." (29 CFR §2510.3-16)

These short ERISA Sections are crystal clear about two things:

1) Every ERISA-covered Plan (examples – 401(a) pension and profit sharing, 401(k), ERISA 403(b)) requires someone be appointed as the *"Named Fiduciary"*; **AND** the *"Plan Administrator"*;

2) If no one is specifically named in the Plan document(s), both positions default to the Employer/Plan Sponsor.

By this point, any business owner would probably be thinking: "Hey, guys, I'm a (fill in the type of business you are in). What do I know about all this?"

Knowledge an Employer/Plan Sponsor must possess

Unless one is in the business of administering retirement plans on a daily basis, the burden of sponsoring a Plan may seem overwhelming. The law surrounding retirement plans is complex because it involves so many important interests.

Here is a sampling of topics about which an Employer/Plan Sponsor must be knowledgeable -

- How to help employees save for their own retirement;
- How to protect employees from both intentional and accidental account depletion;
- How to take advantage of the appropriate tax incentives, both on the company and individual level;
- How to understand that the Internal Revenue Service, the U.S. Department of Labor, and the Securities and Exchange Commission are involved in different aspects of retirement plan oversight;
- How to understand investment techniques and money management;
- How to retain proper documentation in the event of a government audit or participant lawsuit.

By this point, any business owner would probably be thinking: ***"Hey, guys, I'm a (fill in the type of business you are in). What do I know about all this?"***

Well, even the government doesn't really expect you to know all this. However, you are expected to get education and help where needed.

What is needed; and who should be hired

Retirement plan maintenance, under ERISA, involves two *"control and manage"* components:

1) Overseeing the Participants' money; and
2) Overseeing the Plan's day-to-day administrative responsibilities.

In most qualified retirement plans today, it is common that participants are forced to direct their own investment accounts within a limited menu of approved mutual funds, CITs or ETFs. The Employer/Plan Sponsor – or someone to whom it delegates (e.g. an outside 402 Named Fiduciary) must, under Federal Regulations, oversee, on an ongoing basis, the Plan's universe of investment options. This is true even if an outside 3(38) investment manager is hired.

…even if the Plan's investment adviser is a fiduciary, since the Employer/Plan Sponsor retains final authority for the choice of funds, none of their fiduciary risk is reduced by using a 3(21).

Plan Sponsors commonly hire financial advisors who give information about possible investment options. To the extent these providers simply help winnow down the options among which the Employer/Plan Sponsor will choose, they are making recommendations, but not making the final decisions. If they have taken on a fiduciary role (many investment advisors do not), these types of advisors are commonly referred to as "3(21) advisors." ERISA §3(21) defines who is a fiduciary. While every fiduciary is covered under this Section of ERISA, the title "3(21) advisor" has been coopted to refer to financial advisers who give advice about investments, but do not actually choose the Plan's investments. They are a "co-fiduciary". This is not a bad thing; but even if the Plan's investment adviser is a fiduciary, since the Employer/Plan Sponsor retains final authority for the choice of funds, none of their fiduciary risk is reduced by using a 3(21).

> For example, the ABC 401(k) Plan hires a financial advisor to assist in selecting investment options into which participants will direct their accounts. The chosen advisor offers three different options in each of ten different investment categories, such as large cap funds, growth funds, money market funds, and bond funds. ABC (the Employer/Plan Sponsor) chooses five of its executives to make up the 401(k) Plan Committee. That Committee, after consultation with the financial advisor, selects one of the options in each category to offer to its participants.

In this example, the financial advisor narrows the options for the Plan Committee and then the Committee selects among those options which funds will be made available to participants. Since the Committee made the "final" decision, the Committee is still solely responsible for making these choices.

Employer/Plan Sponsors can hire financial managers to take over this investment fiduciary risk/responsibility, commonly called a "3(38) fiduciary adviser." This numerical designation also refers to a separate ERISA Section [4], under which the Plan Sponsor may delegate the fiduciary duty to select the investment options to an outside professional.

For example, the XYZ 401(k) Plan hires a 3(38) financial manager to select investment options for the Plan's underlying participants. The Employer/Plan Sponsor provides the financial manager with certain information about the Plan and its underlying participants. Based on this information, the manager chooses ten investment options that will be made available to Plan participants. This final decision lies with the 3(38), so said manager retains all fiduciary responsibilities regarding these investment choices. Never-the-less, ERISA still requires the Named Fiduciary to determine the 3(38)'s overall performance to be "reasonable".

The second area is administrative in nature. Someone needs to *manage and control* the Plan's administration. Because Plan administration is complex and involves many calculations, virtually all Employers/Plan Sponsors hire outside professionals to help with these duties. Here is a list of typical administrative tasks an Employer/Plan Sponsor would delegate –

- Allocation of contribution/deferral amounts;
- Maintenance of each participant's daily account balance;
- Periodic non-discrimination testing;
- Preparation of participant statements;
- Completion of annual IRS 5500 Series Forms.

These so-called "ministerial duties" are usually performed by outside service providers (commonly referred to as "third party administrators" or "TPAs"). Sometimes the TPA is also the Plan's daily recordkeeper. Sometimes the TPA is a stand-alone provider. Other times, some administrative duties are handled by the Employer/Plan Sponsor's accountants or internal staff.

While TPAs commonly fulfill the technical duties of Plan administration, unless they, in writing, accept the responsibilities of a 3(16) *"Plan Administrator"*, they do not hold this title. Rather, they are the *"Contract Administrator"*. That is, the TPA is contracted to perform certain duties; but in a NON-fiduciary capacity. Consequently, all fiduciary responsibilities related to Plan operation remain with the Employer/Plan Sponsor.

…an Employer/Plan Sponsor may very well have outsourced SOME "plan administration" responsibilities and not realize that they remain responsible for many other fiduciary tasks.

Also be aware that virtually all vendors offering 3(16) services today limit those tasks/duties in which they have accepted a fiduciary role. For example, many 3(16) vendors accept the responsibility of approving/disapproving benefit distributions to participants and signing the IRS 5500 Forms, but nothing else. As ERISA makes clear; any and all fiduciary responsibilities not specifically accepted by an outside party remain with the Employer/Plan Sponsor. Therefore, an Employer/Plan Sponsor may very well have outsourced SOME "plan administration" responsibilities and not realize that they remain responsible for many other fiduciary tasks.

Here are just some of the management-related decisions an Employer/Plan Sponsor must make.

- Determine who is eligible to participate;
- Provide written notices and disclosures to participants;
- Choose and monitor all the various service providers and;
- Manage ALL of the Plan's internal activities.

As Federal Regulations have become more and more complex in recent years, the challenges faced by business men and women who simply want to provide their employee/participants retirement savings have increased. Concurrently, as a particular retirement Plan matures, the amount of money involved also increases, thus exponentially increasing the Named Fiduciary's risk.

Unless an Employer/Plan Sponsor, in writing, delegates administrative responsibilities to an outside 402 *Named Fiduciary*, he or she will always have an obligation under the law to make sure that the chosen advisors are qualified, are "reasonably priced" for the services rendered, and to monitor each vendors performance on an ongoing basis. If the vendor selected does an unacceptable job, the Employer/Plan Sponsor has an obligation to replace them. Even these remaining duties will probably leave an Employer/Plan Sponsor daunted. But again, if the Employer/Plan Sponsor delegates these responsibilities to an outside *402 Named Fiduciary*, he or she has reduced their fiduciary responsibilities in great measure.

The different "flavors" of fiduciary outsourcing

The burgeoning fiduciary outsourcing industry is relatively new. As such, there is not yet any existing "standard" regarding the services offered.

By now, it is likely the average Employer/Plan Sponsor would have found the range of duties and obligations in administering an ERISA-covered Plan to be quite broad. Besides ensuring the employees' needs are met, the person or Committee, or Employer/Plan Sponsor so named as the Plan's *Named Fiduciary,* must review each service provider's reports to ensure their work is correct and complete. Even this oversight role is beyond the abilities of most company owners and executives who are not retirement plan experts and, to be honest, would probably prefer spending more time on growing their business, rather than dealing with retirement plan issues.

The burgeoning fiduciary outsourcing industry is relatively new. As such, there is not yet any existing "standard" regarding the services offered. But in general, there are currently three "models" that relate to the "administration and oversight" of a retirement Plan.

"Limited" Fiduciary services

Sometimes referred to as *"3(16) lite"*, this is the lowest level of fiduciary outsourcing for administration services available in today's marketplace. These types of administrators will generally take responsibility for doing some or all the following tasks in a fiduciary capacity:

- Sign and file the IRS 5500 Services Form on behalf of the Employer/Plan Sponsor each year;
- Approve distributions;
- Approve loans (and set the applicable interest rate on said loans);
- Approve hardship withdrawals;
- Evaluate Qualified Domestic Relations Orders (QDROs) submitted to the Plan regarding participant divorces (these orders legally assign part of the participant's account to the former spouse or children of the marriage);
- Approve corrective measures when a nondiscrimination test is failed.

These services generally do not stray far from that of a TPA in its non-fiduciary capacity. The difference here is that the TPA no longer requires the Plan Sponsor's final approval for each transaction. The 3(16) administrator takes on some responsibility and liability from the Plan Sponsor; but only for those tasks for which they, in writing, have accepted. The significant difference between 3(16) administration, and regular TPA work, is that the 3(16) Plan Administrator can be sued by participants, and the Plan Sponsor, in federal court for its errors, rather than in state court for malpractice or negligence under the term of its contract. Additionally, the 3(16) Plan Administrator can be held liable for any losses to the Plan or its participants suffered as a result of its breach of duty. A regular TPA would probably have a lesser level of liability (and are permitted by law to significantly limit their liability).

NOTE: *It is important to remember that under this arrangement, as the Named Fiduciary, the Employer/Plan Sponsor, retains the sole responsibility of overseeing, evaluating, and determining the reasonableness of fees charged by every vendor, including the 3(16).*

"Enhanced" Fiduciary services

Some TPAs provide a somewhat higher level of services in a fiduciary capacity. Exact services offered vary from provider-to-provider. These 3(16) administrators commonly take on a broader range of responsibilities that are still moored in the Plan's day-to-day administration. Some common services include **(in addition to those discussed in the prior section)**:

- Reviewing the payroll processing reports to ensure that the correct salary deferrals are withdrawn from a participant's paycheck, and that the appropriate matching contributions are deposited on the employee's behalf;
- Reviewing the actual contribution deposits to ensure that all Plan deposits are made on a timely basis;
- Being involved in participant enrollments to ensure their elections were made within the appropriate timeframe;
- Maintaining a "vault" of Plan documentation; and then making it available to participants when requested;
- Providing all required notices and elections to participants on a timely basis.

These mid-level administrators often help the client coordinate with its payroll provider to ensure that the Plan's deferral process is smooth and correct. This may be particularly important if the plan uses "automatic enrollment," where employees are automatically enrolled into the Plan at a given level of contribution after receiving proper notifications.

NOTE: *It is important to remember that under this arrangement, as the Named Fiduciary, the Employer/Plan Sponsor, retains the sole responsibility of overseeing, evaluating, and determining the reasonableness of fees charged by every vendor, including the 3(16).*

"Comprehensive" Fiduciary services

Fiduciary administrators offering this highest level of service endeavor to relieve the Employer/Plan Sponsor of as many obligations as possible under ERISA. This high-touch service essentially "runs" the Plan for the Employer/Plan Sponsor (similar to the CEO analogy mentioned previously). These administrators are typically called "*402(a) Named Fiduciaries".* This term refers to the ERISA Section that mandates someone be named to be in charge of the Plan's administration; again, *"The Buck Stops Here"* person.

A 402 Named Fiduciary typically provides the following decision-related services **(in addition to the services described within the two fiduciary outsourcing levels discussed above)**:

- Takes on the role of the "3(16) Plan Administrator", in writing;
- Acts as the chair of the Plan Administration Committee (PAC), which governs the Plan and makes discretionary decisions. During PAC meetings, the Named Fiduciary serves as moderator, creates the Agenda, and subsequently prepares and issues written Minutes. This goes to satisfying ERISA *Highest Standards* requirement;
- Recommends various plan service providers, including the investment advisor, the daily recordkeeper, the plan auditor, and the third-party administrator. They then negotiate the terms of each vendors contract on behalf of the Employer/Plan Sponsor;
- Acts as the claim administrator, determining when a participant's claim for benefits is to be granted or denied;
- Assists the Employer/Plan Sponsor in:
    - establishing internal controls to ensure the company's benefit-related operations conform with legal requirements;
    - identifying, evaluating, and correcting any Plan operation failures;
    - evaluating and recommending Plan design modifications so as to better meet the company's objectives;
    - evaluating all plan-related vendors, with possible recommendation to *Employer of needed performance improvements.*

"From the perspective of ERISA fiduciary liability, the role of the named fiduciary is unique. Recall that under the general definition of a fiduciary under Section 3(21)(A), a person's potential fiduciary liability is limited "to the extent" the person performs fiduciary functions. The extent of liability under ERISA for a named fiduciary, however, is distinctly different. Under ERISA, the default rule is that the plan's named fiduciary is liable for the ***entire*** (emphasis added) *operation and administration of the ERISA plan."* [5]

Duties retained by Employer/Plan Sponsor after 402 outsourcing

There is no permitted way under ERISA for any Employer/Plan Sponsor to eliminate ALL fiduciary risk. However, virtually all the "heavy lifting" has already been delegated to the 402 Named Fiduciary. After all this comprehensive outsourcing, the Employer/Plan Sponsor typically retains these fiduciary responsibilities-

- Making timely employee-deferral deposits and employer contributions;
- Overseeing proper and timely enrollments of new participants;
- Confirming retention of current service providers, or their replacement;
- Apprising the 402 Named Fiduciary of any material problem, concern, or potential fiduciary breach;
- Monitoring and review of 402 Named Fiduciary;
- Attending and participating in each Plan Administrative Committee (PAC) meeting.

The 402 Named Fiduciary concentrates on the Plan's *"qualitative*" processes. They make sure the Plan is managed properly and ensure that everyone's interests are properly protected, rather than just on the day-to-day ministerial processes. These high-level administrators truly partner with the Employer/Plan Sponsor to provide a meaningful retirement Plan to the participants.

No Employer/Plan Sponsor can legally outsource 100% of their fiduciary risk. However, the time and effort of monitoring and reviewing one 402 Named Fiduciary should be much easier than being responsible to monitor and review multiple retirement plan vendors on an ongoing basis.

Which fiduciary "flavor" is the right one?

Each Employer/Plan sponsor must evaluate their Plan, their participants, and their company's needs in determining what service providers to hire. Here are some things to consider:

- **How large is the Plan?** Larger plans embody more risk; there are more and more people who could become potential plaintiffs. A larger Plan creates a greater potential for significant losses that could merit legal action, and often encounter a broader range of issues that can also give rise to litigation or governmental audit or investigation.
- **How complex is the Plan?** Most Plan Sponsors design a plan to meet every employees' needs. Administering such a Plan is more difficult, with more potential for error. To a Plan Sponsor with little retirement plan knowledge, even a relatively simple Plan, might be considered "complex".

- **What is the Employer/Plan Sponsor's administrative capability?** A company whose head of HR has significant benefits experience may be able to do more in-house than a company whose personnel is stretched thin. A company must consider how much retirement benefits experience exists within the HR department?
- **How much does the employee population fluctuate?** A company with many people joining and leaving the Plan throughout the years, particularly if that influx is due to company acquisitions, will have greater needs, and opportunity for error, than one which is more static.
- **What roles do the other service providers play (and what is left to the Employers/Plan Sponsor's own devices)?** It is important to avoid duplication of services, as well as gaps in service that can lead to noncompliance and the costs associated with a poorly run plan.

If you agree that most Plan Sponsors would rather concentrate on running their own company, every Plan Sponsor needs to outsource their fiduciary risk at some level.

Conclusion

Fiduciary outsourcing provides Employers/Plan Sponsors with broad choices to ensure their Plans operate effectively, efficiently, and correctly. While one might argue that not every Plan needs, or can afford, the highest level of fiduciary services described herein, there are many options for obtaining assistance. If you agree that most Plan Sponsors would rather concentrate on running their own company, every Plan Sponsor needs to outsource their fiduciary risk at some level.

Failure to properly outsource one's fiduciary responsibilities is a true risk for Employer/Plan Sponsors. The main factor for what services the Plan needs should be what is necessary to run it properly; and not concentrate too much on the cost of said services. If the Plan currently has *"hidden"* fees (that is few, if any, expenses show up on the quarterly participant statements), it is likely the Employer/Plan Sponsor will be unaware of the Plan's "actual" fees (for comparison purposes). It would then be difficult, if not impossible, to properly benchmark each vendor's fees relative to the services they provide (or to defend in the event of participant lawsuit or government audit). This would provide even more impetus to seek an outside fiduciary.

"Using outside professional fiduciaries to perform key plan functions can reduce costs due to economies of scale and the use of advanced technology, and can provide access to specialized legal and compliance expertise" [6]

Once the Employer/Plan Sponsor decides what assistance it values, it can then properly benchmark the cost of that assistance and reasonably choose among the available options.

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Source Summary

[1] The Employee Retirement Income Security Act of 1974 (ERISA) is a federal law that sets minimum standards for most voluntarily established retirement and health plans in private industry to provide protection for individuals in these plans.

[2] 29 U.S. Code § 1102.

[3] 29 U.S. Code § 1104(a)(1).

[4] U.S. Code § 1002(38).

[5] June 18, 2014 Statement of Coleen E. Medill Before the ERISA Advisory Council on Outsourcing Employee Benefit Plan Services, page 3.

[6] "Regulating ERISA Fiduciary Outsourcing" by Coleen E. Medill, Robert and Joanne Berkshire Professor of Law, University of Nebraska College of Law, and Of Counsel, Koley Jessen, P.C., L.L.C.; Iowa Law Review [Vol 102:505 2017], page 557.

About the Author | R.L. "Dick" Billings, RF, CPC, CEBS, ERPA

Mr. Billings has more than 42 years of experience in the retirement plan industry. His experience includes starting and growing his own TPA practice for 35 years until selling it in 2019. His firm's services included a daily valuation recordkeeping operation, as well as comprehensive discrimination testing and administration services for both defined contribution (401(k), ERISA 403(b), 457(b)) and defined benefit/cash balance plans. His firm was a *"CEFEX-certified"* firm under ISO 19011.

In 2019, he became a Principal and **Director of Marketing** for Fiduciary Wise, LLC, a nationally-known ERISA §402 "Named Fiduciary" and §3(16) "Plan Administrator" firm for 401(k) and ERISA 403(b) Plans around the country.

While running his own business, he earned a number of industry certifications, such as:

- Registered Fiduciary with DALBAR, Inc. (www.dalbar.com)
- Certified Pension Consultant with the American Association of Pension Professionals and Actuaries (www.asppa.org)
- Certified Employee Benefits Specialist (certified as Fellow) with the International Foundation of Employee Benefit Plans and the Wharton School of the University of Pennsylvania (www.iscebs.org)
- Enrolled to practice before the IRS as a Retirement Plan Agent

Mr. Billings is the frequent author in various trade magazines. Some of his more recent published articles include, *"The Case for a 401(k) Plan 'CEO'"*, "Are You Benchmarking your Retirement Funds Correctly?", and *"Enter the Pooled Plan Provider (PPP) – the "Hot Potato Solution"*. He is a current Member of ASPPA's *Plan Consultant* Magazine Editorial Committee, as well as a presenter of varied retirement-related topics over his many years.

Mr. Billings is a 1979 graduate of the AIB College of Business with a Major in Accounting.