

Outsourcing Defi Plan Fiduciary Ris

by | R.L. "Dick" Billings, CEBS

benefits
MAGAZINE

Reproduced with permission from *Benefits Magazine*, Volume 57, No. 10, October 2020, pages 42-47, published by the International Foundation of Employee Benefit Plans (www.ifebp.org), Brookfield, Wis. All rights reserved. Statements or opinions expressed in this article are those of the author and do not necessarily represent the views or positions of the International Foundation, its officers, directors or staff. No further transmission or electronic distribution of this material is permitted.



ned Contribution k



Single employer plan sponsors may be able to simplify their fiduciary risk by outsourcing many of the fiduciary duties applicable to their 401(k) or ERISA 403(b) plans. The level of responsibility accepted varies by vendor, and plan sponsors should consider factors such as internal expertise and plan complexity when choosing a provider.

Recent regulations and litigation as well as a desire to “do the right thing” have prompted many single employer defined contribution (DC) plan sponsors to consider fiduciary outsourcing.

Fiduciary outsourcing is the delegation of responsibilities and risks under the Employee Retirement Income Security Act (ERISA)¹ to an outside professional who accepts said responsibilities in writing.

ERISA requires sponsors of 401(k) and 403(b) plans to have a *named fiduciary*, which 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 as the *prudent expert rule*.

Plan sponsors can choose to hire an “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)) to run their plans. Service providers that accept both 402(a) and 3(16) responsibilities take most of the legal burdens and liability off the shoulders of employers/plan sponsors. The plan sponsor retains more responsibility if only 3(16) responsibilities are accepted by outside experts.

If the plan documents fail to name an actual person (or persons) as the named fiduciary, it defaults to the employer/plan sponsor. Many employer/

plan sponsors, however, may be totally unaware that their plan document has most likely defaulted this important fiduciary responsibility to them.

It is important to remember that no plan sponsor can completely outsource its fiduciary risk. But most experts can identify more than 50 fiduciary tasks for which every named fiduciary is responsible annually. Reducing one’s fiduciary responsibility to the task of monitoring an outside expert’s performance and a few other largely administrative duties can simplify one’s fiduciary risks. In addition, 402 named fiduciaries typically carry very specific fiduciary insurance, which very few plan sponsors, nor their boards of directors, carry. (Remember that the “10% ERISA bond requirement” is not fiduciary insurance.)

Plan Administration Duties

DC plan administration is complex and involves many calculations. Thus, virtually all employers/plan sponsors hire outside professionals commonly referred to as *third-party administrators* (TPAs) to help with the following administrative duties:

- Allocation of contribution/deferred amounts
- Maintenance of each participant’s daily account balance
- Periodic nondiscrimination testing
- Preparation of participant statements
- Completion of annual IRS 5500 series forms.

Sometimes the TPA is also the plan’s daily recordkeeper. Sometimes the TPA is a standalone provider. Other times, some administrative duties are handled by the employer/plan sponsor’s accountants or internal staff.

learn more

Education

U.S. Employer Outlook: Benefit Strategies for the Future

On-Demand Virtual Conference

Visit www.ifebp.org/virtual for more details.

While TPAs commonly fulfill the technical duties of plan administration, unless they accept in writing the responsibilities of a 3(16) plan administrator, they do not hold this title. Rather, they are the *contract administrator*, which means they are 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 even if the TPA agrees in writing to assume certain 3(16) responsibilities.

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 it remains responsible for many other fiduciary tasks, including the following:

- Determining who is eligible to participate
- Providing written notices and disclosures to participants
- Choosing and monitoring various service providers
- Managing all of the plan’s internal activities.

As federal regulations have become more and more complex in recent years, the challenges faced by business owners who simply want to provide

their employee/participants with an opportunity to save for retirement have increased. Concurrently, as a particular retirement plan matures, the amount of money involved also increases, thus exponentially increasing the named fiduciary's (typically the business owner or plan sponsor) risk.

Unless employers and plan sponsors delegate administrative responsibilities to an outside 402 named fiduciary in writing, they will always have an obligation under the law to make sure that the chosen advisors are qualified and services rendered are "reasonably priced" as well as to monitor each vendor's performance on an ongoing basis. If the vendor selected does an unacceptable job, the employer/plan sponsor has an obligation to replace it. Even these remaining duties will probably leave an employer/plan sponsor daunted.

Employers and plan sponsors that delegate these responsibilities to an outside 402 named fiduciary reduce 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 model for the services offered by providers. But, in general, there are currently three models offered for the administration and oversight of a DC plan.

Limited Fiduciary Service

Sometimes referred to as "3(16) lite," this is the lowest level of fiduciary outsourcing for administration services. These types of administrators generally take on fiduciary responsibility for some or all of the following tasks:

- Signing and filing the IRS 5500 Services Form on behalf of the employer/plan sponsor each year
- Approving distributions
- Approving loans (and setting the applicable interest rate on said loans)
- Approving hardship withdrawals
- Evaluating qualified domestic relations orders (QDROs) submitted to the plan regarding participant divorces
- Approving corrective measures when a plan fails a nondiscrimination test.

These services generally do not stray far from that of a TPA in its nonfiduciary capacity. The difference 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 only for specified tasks and as such 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.

In addition, 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. TPAs that have not accepted this responsibility would probably have a lesser level of liability (and are permitted by law to significantly limit their liability).

The advantage to this lower level service is that distributions are being scrutinized by an outside expert, and distribution mistakes can be quite costly. The disadvantage is that benefits overview and the signing of a 5500 Form constitutes a very small part of a plan's administration. Use of 3(16)-lite model could give a plan sponsor a false sense of security.

Note: 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 Service

Some TPAs provide a somewhat higher level of services in a fiduciary

takeaways

- *Fiduciary outsourcing* is the delegation of responsibilities and risks under the Employee Retirement Income Security Act (ERISA) to an outside professional who accepts those responsibilities in writing.
- ERISA requires sponsors of 401(k) and 403(b) plans to have a named fiduciary. That responsibility falls to the employer or plan sponsor if plan documents fail to name the person (or persons) who hold that role.
- Plan sponsors can choose to hire an "independent expert outside administrator," commonly called a *402 named fiduciary* (as defined under ERISA §402(a)) and/or *plan administrator* (as defined under ERISA §3(16)) to run their plans.
- The plan sponsor retains more responsibility if only 3(16) responsibilities are accepted by outside experts. Hiring a 402 administrator eases more of the fiduciary burden, although plan sponsors can never completely outsource their fiduciary risks.
- Factors to consider when choosing a plan administration service provider include plan size, complexity, the employer's internal capabilities and more.

capacity. Exact services offered vary from provider to provider and are still moored in the plan's day-to-day administration. Some common services include (in addition to those taken on in the 3(16)-lite model):

- 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 that elections were made within the appropriate time frame
- 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 midlevel 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 in the plan at a given level of contribution after receiving proper notifications.

The biggest advantage to this model is that more scrutiny is being placed upon payroll administration, which is a source of many mistakes in retirement plan administration. The disadvantage is possible overlap. If a plan sponsor has competent internal or external payroll staffing, errors are already being minimized. A 3(16) plan administrator will be able to react only to mistakes and is not likely to prevent them.

Note: As with the 3(16)-lite arrangement, 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 Service

Fiduciary administrators offering this level of service seek to relieve the employer/plan sponsor of as many obligations as possible under ERISA. This relatively new service essentially "runs" the plan for the employer/plan sponsor. These administrators are typically called *402(a) named fiduciaries*, and many plan sponsors may be unaware of this service.

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. Common issues a PAC would review include determining whether the plan's underlying investments are efficient, whether each vendor's fees are reasonable or certifying that each vendor's §408(b)(2) notice complies with Department of Labor regulations. During PAC meetings, the named fiduciary serves as moderator, creates the agenda, and subsequently prepares and issues written minutes.
- Recommends various plan service providers, including the investment advisor, the daily recordkeeper, the plan auditor and the TPA, and negotiates the terms of each vendor's contract
- Acts as the claim administrator, determining whether a participant's claim for benefits is granted or denied
- Assists the employer/plan sponsor by:
 - 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 to better meet the company's objectives
 - Evaluating all plan-related vendors, with possible recommendation to the employer of needed performance improvements.

In a statement before the ERISA Advisory Council on Outsourcing Employee Benefit Plan Services, law professor Coleen E. Medill explained the impact of the named fiduciary status. Her statement reads as follows:

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 operation and administration of the ERISA plan.⁴

Under this model, the employer/plan sponsor still retains some fiduciary responsibilities, including the following:

- Making timely employee deferral deposits and employer contributions
- Overseeing proper and timely enrollments of new participants
- Confirming retention or replacement of service providers
- Apprising the 402 named fiduciary of any material problem, concern or potential fiduciary breach
- Selecting, monitoring and reviewing the performance of the 402 named fiduciary
- Attending and participating in each PAC meeting.

The 402 named fiduciary concentrates on the plan's "qualitative" processes. It makes sure the plan is managed properly and that everyone's interests are properly protected, rather than focusing only on the day-to-day ministerial processes.

No employer/plan sponsor can legally outsource 100% of its fiduciary risk; however, the time and effort of monitoring and reviewing one 402 named fiduciary should be less burdensome than being responsible for monitoring and reviewing multiple retirement plan vendors on an ongoing basis.

One of the main disadvantages of comprehensive fiduciary outsourcing is the additional cost. However, some plans may find that they save money because the 402 named fiduciary may uncover unnecessary expenses.

Choosing the Right Model

Employers and plan sponsors must evaluate their plan, their participants and their organization's needs in determining what service providers to hire. The following are some factors 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. Such plans also can encounter a broader range of issues that can also give rise to litigation or governmental audit or investigation. Depending on the owner's expertise, a small business owner might consider a plan with \$1 million in assets as large.
- **How complex is the plan?** Features and requirements such as target-date funds, autoenrollment/autoescalation and new part-time eligibility rules all tend to make retirement plans more and more complex.

bio



R.L. "Dick" Billings, CEBS, ISCEBS-Fellow, CPC, ERPA, RF, is principal

and director of marketing for Fiduciary Wise, LLC, an independent consulting firm that serves as an

Employee Retirement Income Security Act (ERISA) Section 402(a) and 3(16) plan administrator for 401(k) and ERISA 403(b) plans throughout the United States. He is the founder and former CEO of Billings and Company, Inc., a recordkeeping and third-party administrator firm, which was sold in 2019. Billings is a frequent presenter and contributor to several retirement plan-related publications. He is a graduate of the American Institute of Business, where he majored in accounting.

- **What is the employer/plan sponsor's administrative capability?** Employers must consider how much internal retirement benefits experience their staffs have.
- **How much does the employee population fluctuate?** If employer turnover is frequent or if new employees are joining because of acquisitions, there may be more opportunities for error.
- **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.

Conclusion

Fiduciary outsourcing may be an option for employers and plan sponsors looking 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 in this article, there are many options for obtaining assistance. 📌

Endnotes

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



pdf/920