

Understanding Fiduciary Services, Does Outsourcing Work For You?

An overview of defined contribution plan fiduciary types.

By Stephen Abramson

Given intensifying scrutiny of fiduciaries in the courts and public-square, PSCA encourages readers to understand the nuanced world of fiduciary services, to educate colleagues about the role and importance of the fiduciary, and to lead their organization's through conversations about whether outsourcing fiduciary services will work for the organization.

The Employee Retirement Income Security Act of 1974 (ERISA) defines fiduciary in §3(21)(A): *“...a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.”*

As a plan sponsor, trustee, or member of the plan's investment or administrative committee, item (ii) generally doesn't apply. It becomes clear that the individuals and trustee(s) exceed “ministerial duties” and satisfy (i) and (iii) when they exercise “discretionary authority” or control in the operation of the plan.

By way of example, individuals satisfy the definition when they:

- Determine when an employee is eligible, if an employee meets the guidelines for a hardship distribution, whether the employee is eligible for a loan if the plan allows for loans

- Decide if and when a terminated employee should be paid out, and disposition of plan assets
- Pay plan expenses from the assets of the plan
- Select and retain plan service providers
- Enter into plan transactions

For most of these functions it is possible to engage a third party fiduciary to accept these responsibilities as co-fiduciaries. Although this does not necessarily relieve the internal fiduciaries of their fiduciary duty, it does provide professional, experienced organizations to insure that all fiduciary responsibilities are being satisfied.

What are Fiduciary Responsibilities?

A plan fiduciary must act solely in the best interest of plan participants and beneficiaries for the purpose of providing benefits to the participants. They must carry out their duties prudently, follow the plan document, diversifying investments and paying only reasonable expenses. Best practices dictate that all fiduciary decisions should be documented since the Department of Labor will focus on the process followed in exercising fiduciary duty. For example, when a plan hires a third party vendor, whether it be a record keeper, investment advisor, or Third

Party Administrator, the process used to arrive at the chosen vendor should be documented along with the basis for choosing one over another. The fiduciary standards do not imply that the fiduciary must choose the least expensive vendor, but the vendor whose services are consistent with their fees.

Also keep in mind that each fiduciary is responsible for the acts of their co-fiduciaries and taking proper steps if the fiduciary has knowledge that a co-fiduciary has breached their fiduciary duty — including outsourced fiduciaries.

A fiduciary breach is not necessarily based on the end result, but more importantly, on how the fiduciary arrived at the end result.

Outsourcing Fiduciary Responsibilities

If a fiduciary is outsourced it is still the responsibility of the internal fiduciaries to monitor the services being provided. This includes monitoring the third party fiduciary's performance, reviewing reports provided, confirming fees being charged, and periodic benchmarking of those fees.

The act of hiring a third party fiduciary in and of itself is a fiduciary function. Inquiries should be made as to the outside fiduciary's experience and qualification of their professional staff. In addition, the individual

responsible for the plan should be interviewed and inquires made about any adverse actions against the firm including litigation or enforcement. At the risk of being repetitive, be sure to document the process of hiring the third party fiduciary.

Although all qualified retirement plans, other than “one person plans,” as defined in IRS regulations, must secure an ERISA fidelity bond, that bond does not relieve the fiduciary from personal liability in the event of a fiduciary breach. The ERISA bond is meant to protect the plan in the event of loss to the plan due to fraud or dishonesty on the part of the bonded fiduciaries. In addition to an ERISA fidelity bond, a fiduciary can purchase liability insurance that would cover the cost of plan corrections, defense costs, and regulatory penalties among other costs due to their fiduciary breach that would otherwise be the fiduciary’s responsibility.

Considering the Department of Labor’s intensified focus on fiduciary compliance, particularly in the last few years as supported by the rash of litigation, it is important to be familiar with fiduciary outsourcing options available to plan sponsors.

Types of Third Party Fiduciaries

ERISA, in Section 3, sets forth three categories of fiduciaries: an Investment Advisor as provided in section 3(21), an Investment Manager as provided in section 3(38), and a Plan Administrator (PA) as provided in section 3(16).

3(16) Plan Administrator

Let’s begin with the last first, the Plan Administrator. The Plan Administrator function does not involve investment advisory services but focuses on the general and specific operations of the plan. A 3(16) plan administrator would offer any or all of the following services:

Plan Management/Administration

- Selection and monitoring of trustees
- Selection and monitoring of service providers, e.g., record keepers
- Selection of the plan document provider
- Selection and monitoring of the investment advisor
- Evaluation of plan fees
- Delegation of administration responsibilities to other fiduciaries

Operation of the Plan

- Interpretation of the plan document
- Timely reporting to participants and government agencies
- Benefit payments
- Administration of QDROs and loans

A 3(16) Plan Administrator may also provide certain services that are not considered fiduciary functions, generally referred to as “ministerial duties.” The basis for this position is that the 3(16) Plan Administrator is following guidelines established by others and therefore does not have discretionary authority over the administration of the plan.

Examples would include applying the eligibility requirements, preparing the form 5500, preparing benefit statements, or suggesting a course of action to a fiduciary that does have discretionary authority. When engaging a 3(16) Plan Administrator, the plan sponsor should decide which functions will be offloaded rather than the 3(16) Administrator setting that guideline. In some cases the 3(16) Plan Administrator will offer bundled services and base their fee on that prepackaged service. If some of those services are not required, the plan sponsor is paying for services they will provide elsewhere. When choosing a 3(16) Plan Administrator or any outside vendor, remember to document the process and provide the same guidelines/services being requested to all proposing vendors.

3(21) Investment Advisor

A 3(21) Investment Advisor does just that — provides advice for a fee, but has no discretionary authority. Their responsibilities would include recommending plan investments — recommending a group of mutual funds or similar investments for a 401(k) or 403(b) plan to be offered to employees. In addition, the Investment Advisor may advise on creating model portfolios offered to participants and monitoring those portfolios for allocation adjustments as the marketplace reacts to economic changes. If requested, the Investment Advisor may be available to meet individually with employees to assist them in establishing their asset allocation based on their risk tolerance including ongoing updates. Some 3(21) Investment Advisors will go further and provide call-out services to participants based on specific guidelines, e.g., more than 50 percent of their account in cash, or more than 25 percent of their account in any one fund (other than a Target Date fund). In addition, webinars may be offered to participants on general investment topics and concepts. As in the case of the 3(16) Plan Administrator, it is the plan sponsor’s responsibility to determine which services should be provided and what a reasonable fee is to provide those services.

3(38) Investment Manager

Lastly we have the 3(38) Investment Manager. ERISA Section 3 provides that a 3(38) Investment Manager be registered as an investment advisor under the Investment Advisors Act of 1940 and has acknowledged in writing that he or she is a fiduciary with respect to the plan. An Investment Manager would offer all of the services of a 3(21) Investment Advisor, but in addition would have discretionary authority to change the funds being offered based on a set of acceptable metrics, e.g., benchmark performance, tenure of manager, and measure of

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volatility among others. Although the Investment Manager has the discretionary authority, it does not relieve the plan sponsor from fiduciary liability if the Investment Manager does not perform their duties in a prudent manner. As is the case when the plan sponsor engages a third party vendor, particularly an outsourced fiduciary, the choice of that third party is a fiduciary function of the plan sponsor and anyone else involved in the decision. It has been made clear in various court cases that it is the plan sponsor's responsibility to provide due diligence on the funds being offered to the participants in their plan. This function can be provided by a 3(21) or a 3(38) ERISA fiduciary that has been hired to provide outsourced fiduciary services and should be reviewed quarterly.

Plan Audits

Due to the deep relationships some plan sponsors form with their vendors, it can be difficult to objectively assess the vendor's services. As a result, some outside fiduciaries have developed assessment services that will audit a plan's fiduciary compliance as an independent engagement.

The independent plan audit can cover fiduciary issues such as due diligence on the funds offered, timely remittance of salary deferrals, timely payment of benefits to terminated employees, and benchmarking of fees, among others. Generally the cost of the audit is based on the size of the plan, i.e., number of participants, and the specific fiduciary rules to be reviewed. Dependent on the extent of the audit and the responsiveness of the plan to provide necessary information, the process can take from a few weeks to a few months.

Once a plan audit is complete, a Compliance Opinion Letter should be provided to the plan sponsor for review. Any non-compliant issues should be brought to the attention of the vendor who is responsible for that function, e.g., the investment advisor, and a process for correction established. The audit should be done by an Accredited Investment Fiduciary Investment Analyst who is certified by the Center for Fiduciary Excellence (CEFEX). The Center is an independent global assessment and certification organization. It works closely with investment fiduciaries and industry experts to provide assessment pro-

grams to improve risk management and fiduciary compliance for institutional and retail investors. CEFEX provides an independent recognition of a firm's conformity to a defined Standard of Practice and implies that a firm can demonstrate adherence to the industry's best practices, and is positioned to earn the public's trust.

Conclusion

To conclude, following is a list of what have we learned in this article;

- Who is a fiduciary
- What is a fiduciary's responsibilities
- Fiduciary compliance is the responsibility of plan sponsors and trustees
- Fiduciary services can be outsourced
- Fiduciaries are responsible for their co-fiduciaries
- Fiduciary assessment services should be done by qualified individuals
- **Document every fiduciary function in which you participate**

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