# Service Provider Selection and Monitoring

## A Guide to Understanding Your Fiduciary Responsibilities

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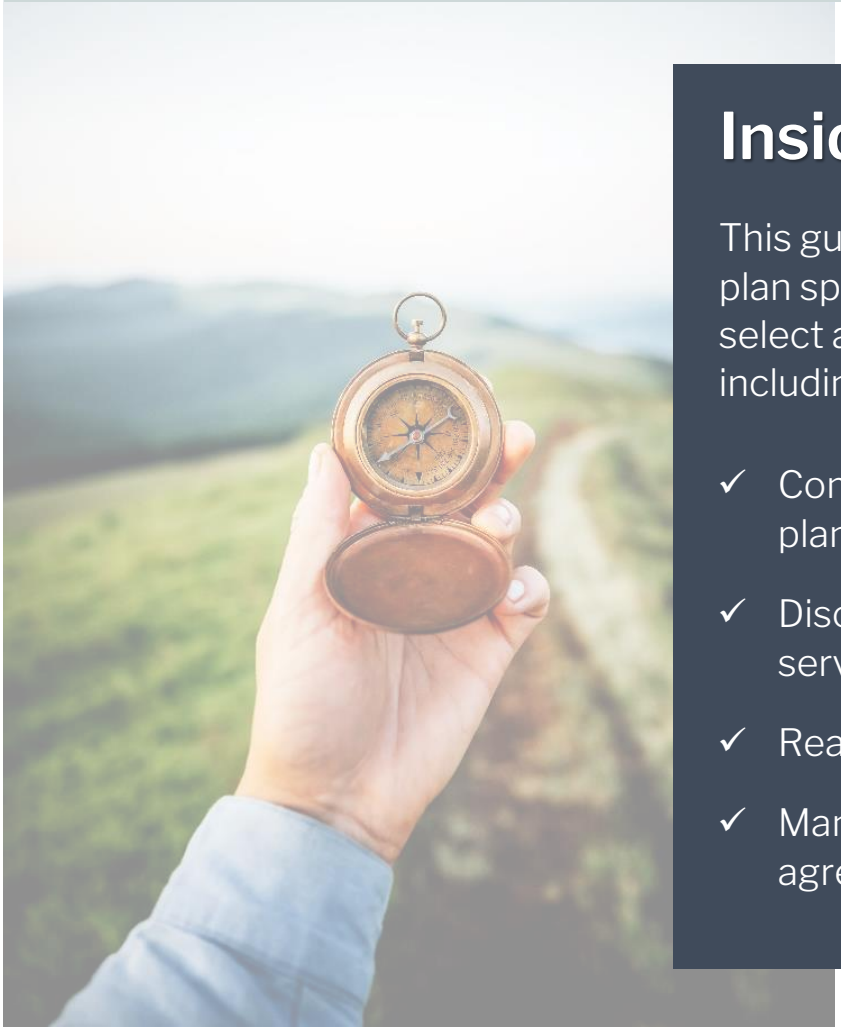
# Plan sponsor responsibilities.

As a plan sponsor, you have assumed the duty to protect your plan participants and beneficiaries under the Employee Retirement Income Security Act (ERISA). Those responsibilities include prudent selection and monitoring of service providers and making sure that participants pay no more than reasonable fees for those service providers.

As you have learned, plan sponsors have many responsibilities related to running the retirement plan. Selecting and monitoring service providers is just one of them. Some of these responsibilities are complex and frequently change due to new legislation and regulation. Fortunately, the law does not require plan sponsors to do this all on their own. ERISA allows plan sponsors to hire experts, so long as they are prudently hired and do not cost more than a "reasonable fee." What's reasonable you ask? This guide will help you explore this and more.



## Inside this guide . . .

This guide will cover the critical topics plan sponsors need to understand to select and monitor service providers including:

- ✓ Common service providers to the plan
- ✓ Disclosure requirements for service providers
- ✓ Reasonableness of fees
- ✓ Managing service provider agreements

# Here's What You Really Need To Know:

Hiring service providers is a fiduciary obligation that requires a prudent process.

A plan sponsor's fiduciary obligation does not stop with hiring service providers. Plan sponsors are also responsible for monitoring service providers. When hiring and monitoring service providers, plan sponsors must document the steps taken.

Service providers who are expected to be paid $1,000 or more in a year are considered "covered service providers" for purposes of the disclosure requirements under ERISA Section 408(b)(2). This means plan sponsors need to collect and analyze a disclosure of fees, services, and fiduciary status initially and any time there is a change to fees, services, and fiduciary status.

Once you, the plan sponsor, understand these important responsibilities, you can then continue learning more about your fiduciary obligations related to selection and monitoring of service providers. Examples include fee policies and fee equity, conducting requests for proposals, managing service provider conflicts of interest, cybersecurity, and determining how service providers handle small sum distributions.

# Service Providers to the Plan

**Not all plans have the same service providers or companies who provide said services to the plan.**

In fact, few service providers are required to run a plan. According to the DOL, the only required service providers include: (1) a recordkeeping system to track the flow of monies going to and from the retirement plan and (2) a trust fund to hold the plan's assets. In many cases, the same service provider selected to be the recordkeeping system is likely to be the trust company. This section will outline several service providers that the plan may use, but are not all required to use.

Some are more common depending on the needs of the plan, its participants, and the plan sponsor. Plan sponsors should start by determining what level of expertise they possess to manage the retirement plan. If they have very little expertise, a plan sponsor will need to utilize many service providers. If the plan sponsor is already proficient in most aspects of running the plan, additional service providers may not be needed. Common service providers to a retirement plan include but are not limited to:

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| **Recordkeeper** | Tracks the assets in the retirement plan and administers the plan in accordance with the plan document. |
| **Custodian/Trust** | Holds and provides safekeeping of the plan assets. |
| **Third-party Administrator (TPA)** | Manages day-to-day aspects of the retirement plan such as loans, hardships, and notices. |
| **Investment Advisor or Investment Manager** | Provides investment advice and may assist with day-to-day coordination of the plan. |
| **Attorney** | Ensures legal and regulatory compliance and assists with governance. |
| **Auditor** | Protects the plan's legal integrity and helps meet the plan's annual audit requirement by conducting the audit to attach to Form 5500. |
| **Education/Financial Wellness Provider** | Provides non-fiduciary services that range a spectrum to assist employees with meeting their needs to increase savings and prepare for retirement including budgeting, paying down debt, etc. |

This is not an exhaustive list of service providers nor their associated services, and it is important to understand the array of support available for plan sponsors to carry out their responsibilities. When paid for by the plan, it is important to keep in mind that service providers can only be for the benefit of the participants and beneficiaries. Service providers cannot be hired to benefit the employer or for some other benefit beyond the participants and beneficiaries.[1]

[1] This topic is beyond the scope of this plan sponsor guide. However, plan sponsors should be aware that their obligation is exclusively for the benefit of the plan participants and beneficiaries. When hiring a service provider that does not advance the interests of the participants and beneficiaries, plan sponsors should ensure it is not paid for from plan assets and should consider the nature of the engagement. For example, some purported financial wellness programs are not related to the retirement plan and instead advances the interests of the employer.

# Pooled Employer Plans (PEP)

Another type of service provider structure is to partner with other employers and hire a pooled plan provider (PPP) in a pooled employer plan (PEP). This structure was authorized under the Setting Every Community Up for Retirement Enhancement (SECURE) Act, and it allows unrelated employers to participate in the same retirement plan and shift responsibilities to the PPP.

In a PEP, PPPs generally serve as the primary fiduciary, responsible for selecting all other service providers. The plan sponsor would initially prudently select and continually monitor the PPP, while the PPP becomes responsible for the prudent selection and monitoring of all other service providers.

*This is an alternate structure to plan formation and hence an alternate process for service provider selection and monitoring.*

# Disclosure Requirements for Service Providers

Historically, the retirement plan marketplace was dominated by high fees and unclear fee structures. In the mid-2000s, fee litigation in the mega-plan space brought attention to the cost and transparency of fees for retirement plans and their service providers. The DOL-issued regulations (effective in 2012) required plan sponsors to better understand the cost associated with retirement plans. These regulations require what is often referred to as "408(b)(2) disclosures" because of the code section under which they originated. Many times, plan sponsors are unaware of this separate disclosure because the disclosure itself is built into the contract between the plan sponsor and the service provider.

**Regardless of where it is located – separate document or the contract – it is important for plan sponsors to:**

- Receive the information (described on next page)
- Review and analyze the information (and ask questions where necessary)
- Document the review

## *Analyzing 408(b)(2) Disclosures*

Hiring service providers is a fiduciary obligation and hence requires a prudent process. Part of that process should include reviewing the 408(b)(2) disclosure for each service provider. Begin by taking an inventory of all of the service providers to the plan that expect to receive $1,000 or more in compensation from an ERISA-covered plan during the year; each of these service providers is known as a "covered service provider" under the rules.

Each time a 408(b)(2) is issued, the plan fiduciaries should review and analyze the information to determine if the services are necessary and if the fees are reasonable given the services rendered. Additionally, plan fiduciaries should periodically undertake a review of 408(b)(2) disclosures by doing the following, which is further discussed in the next section:

1. **Identify** all covered service providers to the plan
2. **Determine** the date the last 408(b)(2) was provided by each service provider
3. **Review** for the three required parts
4. **Evaluate** the needs of the plan and its participants
5. **Analyze** fees in light services provided and in alignment with plan and participant needs
6. **Determine** if the fees are reasonable
7. **Document** the review
8. **Revisit** the above analysis periodically

**Covered service providers are required to disclose the following, initially and every time there is a change in the relationship with the plan:**

| Required | 1 SERVICE DESCRIPTION | 2 FIDUCIARY STATUS | 3 FEES |
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# Reasonableness of Fees

The DOL summarized fiduciary obligations under ERISA Section 404 by explaining that the primary responsibility of fiduciaries is to run the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits, paying only reasonable plan expenses (also known as the duty of loyalty). Fiduciaries must act prudently (also known as the "duty of care" which requires that fiduciaries follow a process) and must diversify the plan's investments to minimize the risk of large losses.

As described in this guide, plan fiduciaries have a responsibility to ensure that the services provided to their plan are necessary and that the cost of those services is reasonable. However, reasonableness is often difficult to assess for plan fiduciaries. Fees are important when considering both service providers and investments, but for purposes of this guide, we will primarily stick to service providers (though the concepts apply similarly). The DOL said "This responsibility [of understanding and evaluating plan fees] is ongoing. After careful evaluation during the initial selection, you will want to monitor plan fees and expenses to determine whether they continue to be reasonable in light of the services provided."[2]

## **The Prudent Process:** To determine the reasonableness of fees, as a plan sponsor, you will want to proceed with a prudent process:


**1. Identify framework**: Determine the needs of the plan and participants to understand which services you need initially and reevaluate over time as it relates to each service provider.

**2. Gather information**: To fulfill this step, according to the DOL, "service providers must provide certain information to you about the services they will provide to your plan and the compensation they will receive [known as the 408(b)(2) disclosure]. This information will assist you in understanding the services, assessing the reasonableness of the compensation (direct and indirect), and determining any conflicts of interest that may impact the service provider's performance."

**3. Evaluate objectively**: Evaluate based on the needs of your plan and also benchmark fees based on other plans that are similarly situated to determine what fees are reasonable.

**4. Decide + document**: Make a determination as to what is reasonable. Keep in mind that the DOL and courts agree that cheapest does not equate to reasonable. The DOLhas specifically stated, "Nor is cheaper necessarily better." It is important to make a comprehensive evaluation and document.

**5. Revisit periodically**: Things change over time and, of course, should be periodically revisited.

2 See DOL, Understanding Retirement Plan Fees, available here: https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/publications/understanding-retirement-plan-fees-and-expenses.pdf.

# Managing Service Provider Agreements

The 408(b)(2) disclosure is only one part of the service provider arrangement that requires review; service provider contracts are complicated given that other areas of negotiation also require a keen eye, understanding, and often negotiation.

ERISA is a law of process and documentation and is not outcome-focused. There are two key concepts for plan fiduciaries to keep in mind when reviewing arrangements with service providers. First, it is not enough under ERISA to take the approach that "bigger organizations are using this service provider so you can too." ERISA requires that you follow a prudent process, and the act of going through the process helps you fulfill your fiduciary obligations in prudently selecting and monitoring a service provider. Looking around the marketplace and seeing that XYZ mega-company also uses XYZ mega-recordkeeper falls short of your due diligence on XYZ recordkeeper because their process might have rendered different negotiations.

Second, in some cases, it might seem fruitless to negotiate a certain provision in an agreement because the other party may be the larger service provider. However, the act of negotiating will provide documentation of your attempts at a certain outcome – even if you are unable to attain them because of a bigger service provider's leverage.

When reviewing service provider agreements, plan fiduciaries are always encouraged to work with competent counsel, versed in both basic contract law but also ERISA. Areas for consideration when reviewing contracts beyond fees, services, and fiduciary status include:

> **Additional services**: In some cases, there may be an opportunity to generate additional revenue beyond the fees for servicing retirement plans for which the relationship (and contract) was originally created. In these instances with a recordkeeper, for example, there may be additional services included in the agreement for managed accounts, financial wellness, and other services, which may or may not require a fee. Plan sponsors should watch for additional services that are added to the contract to determine if they are within the spirit of the agreement and if they should be properly paid from plan assets. In other words, do the plan and its participants require these additional services? If not, these additional services should not be included.

> **Privacy and cybersecurity:** Given the DOL's April 2021 guidance related to cybersecurity, plan sponsors should monitor and negotiate accordingly to ensure that to the extent possible, the DOL's cybersecurity guidelines are met. Along with these provisions, to the extent applicable, there are often guarantees or warranties to make a participant whole (e.g., by restoring funds to a participant's account after a cybersecurity breach) depending on the steps the plan sponsor and participant take when a breach occurred; plan sponsors should evaluate these warranties and make them as liberal to the plan and its participants as possible.

**Plan data considerations:** Plan sponsors should review their agreements with service providers with an eye toward their plan data to determine how their participant data might be utilized and if it will be provided to third parties or used to sell additional services from the service provider or other third parties.

**Service level guarantees:** As a result of service provider consolidation, routine service becomes more challenging for plan sponsors and participants. Plan sponsors may want to more closely review service level guarantees in their agreements for participant response times, for example.

This is not an exhaustive list of service provider agreement terms, but this is a snapshot of considerations to review in addition to basic contractual terms such as venue, indemnification, and many others. In all instances, working with competent counsel will be helpful initially and on an ongoing basis.

**This guide has provided an introduction to the fiduciary obligation that requires plan sponsors to prudently select and review service providers. While ERISA does allow plan sponsors to shift responsibility to service providers depending on their level of expertise, there always remains a responsibility of plan sponsors to monitor those service providers to whom they have delegated and to ensure these service providers are paid a reasonable fee.**

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