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ERISA Advisory Council Issues Outsourcing Report

The ERISA Advisory Council issued a report in January on the outsourcing of retirement and welfare plan administration to service providers. The report findings identify areas of confusion for plan sponsors and fiduciaries — particularly whether fiduciary responsibility has been shifted as a result of outsourcing and how to properly select and monitor a service provider. The council's report includes recommended guidance that the DOL should issue that would be helpful for plan sponsors and fiduciaries. In addition, the council also looked at the role of multiple employer plans and their potential for expanding retirement plan coverage for small employers.

Background

The ERISA Advisory Council identified outsourcing as an issue to study in 2014. The council's goals were to understand current practices, and to identify steps the DOL should take that would be helpful for plan sponsors, participants, and service providers. See our September 26, 2014 *For Your Information* for details on witness testimony at two hearings that the council held on outsourcing last year.

The council's report includes a summary of current outsourcing practices and ERISA's fiduciary concepts, and identifies areas of confusion for plan sponsors and plan fiduciaries. The report contains a number of recommendations for additional DOL guidance.

Areas of Confusion

In its report, the advisory council reviewed current outsourcing practices and rules and noted a number of areas of confusion for plan sponsors and fiduciaries:

- **Outsourcing to limit fiduciary risk.** The council notes that limiting fiduciary risk is often cited by plan sponsors as a reason for outsourcing plan administration functions, but a number of witnesses testified that plan sponsors may be unaware that they have not adequately delegated their fiduciary responsibility to the provider or might be serving as a co-fiduciary with the provider.

- **Fiduciary status of plan service providers**. The report observes that some service providers expressly undertake fiduciary roles for their clients, while others may disclaim the role contractually. The report notes that many clients may not understand that there is a functional element to fiduciary status — with the result that a plan service provider who exercises discretionary control over plan assets, management, or administration is a fiduciary under ERISA, regardless of whether the provider has agreed to such status contractually.
- **Duty to select and monitor service providers.** The council notes that DOL guidance on a fiduciary's duty to select and monitor a service provider is scattered among a number of publications — such as interpretive bulletins, field service bulletins, information letters, advisory opinions, and various publications for employers — and often involves the application of ERISA to specific fact patterns. As a result, the guidance may be easy to miss and, if found, involves fact patterns that may be difficult for plan sponsors to translate to their specific situations.
- **Benchmarking standards.** The report notes that there are few industry standards for measuring the performance of plan service providers outside of investment management services.
- **Multiple Employer Plans (MEPs).** The report notes that current DOL guidance restricts the ability of unrelated employers in different industries from forming MEPs.
- **Bonding.** Bonding is required under ERISA to protect plans against fraud. The report notes that plan sponsors and service providers are often confused about the activities requiring bonding and who must be bonded, and that DOL guidance on the issue consists of temporary regulations issued in 1975 and a field service bulletin issued in 2008.

What is a multiple employer plan (MEP)?

A MEP is a retirement plan that has been adopted by two or more unrelated employers.

Witnesses before the council generally testified that greater availability of MEPs would encourage smaller employers to adopt retirement plans. This is because the MEP structure allows for adopting employers to outsource almost all plan administration functions to a third party.

The cost of such outsourcing may not be feasible for a small employer with a single employer plan; but economies of scale are realized as the number of employers and participants in a MEP increases.

The council's report notes that there is a tension between the degree of outsourcing available under the MEP structure and the harm that can result to plan sponsors and participants from bad-actor service providers who are not properly monitored.

Recommendations

The report includes a number of recommendations for the DOL, detailed below.

Education on current practices

The council recommends that the DOL provide more education to plan sponsors on outsourcing such as information about the range of outsourcing options and the types of providers. The council also believes that more information on contracting practices would be helpful — for example, the ability to terminate a contract, indemnification for errors, and caps on the outsourcer's liability.

Volume 38 | Issue 39 | March 16, 2015

Guidance on fiduciary liability and hiring plan service providers

The council believes that the DOL should clarify the legal standards applicable to plan fiduciaries in the following areas:

- The plan sponsor's fiduciary duties when the plan document designates a named fiduciary other than the plan sponsor
- A plan fiduciary's scope of liability when the fiduciary hires a service provider who is not a fiduciary
- Whether a plan fiduciary who hires another fiduciary has obligations beyond the duty to select and monitor the hired fiduciary
- More guidance on the standard of knowledge required to hold a co-fiduciary liable for the actions of another fiduciary

The council also recommends that the DOL issue more guidance for plan sponsors on their liability for selecting and hiring plan service providers — such as guidance on the frequency and scope of the monitoring that should be performed on service providers, best practices for selecting providers, and identifying and resolving potential conflicts of interests when hiring providers.

MEPs

The council believes that multiple employer plans (MEPs) could encourage plan formation and urged the DOL to consider the benefits of MEPs when issuing guidance. The council suggested that the DOL develop a model MEP structure to serve as a guide for addressing conflicts of interest, prohibited transactions, fiduciary independence, and disclosure. The council also thought it would be helpful for the DOL to issue guidance on when adopting employers of a MEP are and are not liable for mistakes and other noncompliance by other adopting employers.

Bonding

The council urges the DOL to issue additional guidance on the fidelity bonding requirements for plan service providers, and to educate plan sponsors on fiduciary insurance coverage — both in terms of availability and how the policies work (e.g., scope of coverage, deductibles, policy limits).

In Closing

The council's report on outsourcing includes a lengthy list of recommended additional guidance the DOL could provide to improve plan service offerings. It remains to be seen whether the DOL will take up any of the recommendations. There are reports that the DOL is likely to issue revised proposed regulations on the definition of a fiduciary later this year as we discuss in our February 24, 2015 *For Your Information*. Those regulations, however, will not address the recommendations made by the council's report.

Volume 38 | Issue 39 | March 16, 2015

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