Analysis&Perspective

FIDUCIARY RESPONSIBILITY

Plan fiduciaries may face risks, including personal liability, when corporate decisionmakers turn their attention to retirement and welfare plan administration as a source of savings in perilous economic times. The authors discuss some of the most notable areas for possible ERISA violations when fiduciaries face corporate cost-cutting pressures.

Switching 401(k) and Other ERISA Plan Vendors—Inherent Risks for Employers and Plan Fiduciaries

BY J. MARK POERIO AND ERIC R. KELLER

Introduction.

An economic downturn invariably multiplies the instances under which corporate officers and directors face cash-flow issues and cost-cutting initiatives. These issues come packed with fiduciary concerns, conflicts of interest, and risks of personal liability when corporate decisionmakers turn their attention to their company's retirement and welfare plans (together "ERISA Plans," because they are subject to the Employee Retirement Income Security Act of 1974 (ERISA)).

Cash-flow problems may create conflicts of interest with respect to transmitting employer and employee contributions to ERISA Plans, and may prompt employers to consider switching to less expensive ERISA plan service providers, such as trustees, investment managers, and recordkeepers (also known as third party administrators or TPAs). Savings are often possible, at least on the surface, due to often intense competition among ERISA plan vendors.

Any ERISA-related downturn strategies come with subtle costs, however, in the form of fiduciary risks that have increased in part due to active—and escalating—Department of Labor (DOL) oversight of pension and welfare plans. Consequently, ERISA plan sponsors and individual fiduciaries risk personal liability if they underappreciate or overlook their ERISA responsibilities. Hidden fees, inequitable contract terms, vendor selection, and cash-flow pressure are perhaps the most notable sources for ERISA stumbles when fiduciaries face corporate cost-cutting pressures. The reasons are as follows.[1]

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Vendor Selection. When it comes to saving costs for ERISA plan services, the discussion normally centers on assessing current vendor services and considering alternatives. Those responsible for vendor selection have a duty of prudence under ERISA. This requires their careful evaluation of any vendor's qualifications, the nature and extent of the services being offered, and, when plan assets are being used to compensate the vendor, the reasonableness of the vendor's fees in view of the services provided.

The ERISA fiduciary should thoroughly document the process by which it evaluates each of these considerations, as well as why a particular vendor gets selected. One way to do this is by using a formal request-for-proposal (RFP) process.

An RFP is an effective way to solicit the information necessary to make an informed selection and to document that the fiduciary met its fiduciary obligations in selecting the vendor. An RFP request typically will provide basic background information about the employer, the plan, other plan fiduciaries and the services being requested. In addition, it is wise for the RFP to include a proposed form of contract that reflects careful attention to the interests of the ERISA plan and its fiduciaries. By asking vendors to submit their contract changes with their RFP, the employer and ERISA plan fiduciaries may best steer the future contract negotiation toward terms critical and favorable to them.

For tax-qualified 401(k) and other retirement plans, significant cost savings are often possible through the switch from an individualized plan (under which the employer generally pays for the countless refinements necessary to conform with changing tax laws) and a prototype plan (under which the vendor builds those costs into a fee model that is dramatically more cost effective). Another driver for cost savings will come from

[1] Detailed information appears in Keller, E., *Meeting Your Fiduciary Duties in Vendor Selection and Management,* Human Resources 2007, Summer Edition.

bundling plan services, because plan sponsors will often find increased bargaining power with potential vendors.

A holistic assessment of plan services has the further potential to streamline both benefits and systems, and thereby to mitigate the cost magnification that can come from pyramiding plans on a piece-by-piece basis. There are other cost-saving alternatives whose value varies depending on company facts and circumstances. The key for employers is to take the occasional step back for a global benefits assessment.

Vendor Fees. For a few years now, ERISA plan sponsors have been hearing about—or been victimized by—largely gadfly litigation alleging inadequate monitoring of the fees that ERISA plans pay for vendor services (mostly related to plan investments). These cases are still making their way through the courts, with none having yet reached notable resolution. Meanwhile, the DOL has chimed in with three different regulatory initiatives that all require plan fiduciaries to understand and properly disclose the compensation paid to plan service providers.[2] This focus of litigation and regulation on vendor fee arrangements should forewarn plan fiduciaries that they should be ready to justify the financial terms of the contracts that they approve with plan service providers. Consequently, when evaluating vendors from a fee perspective, ERISA fiduciaries need to dig into service proposals for total real costs.

There are marketing strategies that can make promised cost savings appear more significant than they will be. For example, a common tactic shifts fees from employers to plan participants—with the DOL leading efforts to assure full disclosure of these types of charges. Unanticipated fees may also arise from front-end investment loads or back-end surrender charges or service termination charges. Even after negotiating fee arrangements, ERISA fiduciaries should monitor fees to verify that they are not only consistent with the fees agreed to but only that they continue to bear a reasonable relationship to the services received. The latter should be done in conjunction with annual benchmarking that compares the fees charged for current plan services with those charged by competing vendors for similar services.

Inequitable Contract Terms. When ERISA plan sponsors switch providers, they often receive the vendor's standard documents, inclusive of standard terms. It is not uncommon to encounter one-sided indemnification provisions that protect only the vendor, or provisions that limit the vendor's liability to gross negligence or gross misconduct. ERISA fiduciaries should consequently be careful to negotiate for the best possible terms for vendor services—from terms of hire to termination—and work with ERISA counsel to ensure that the contract complies with legal requirements that do not expose the plan's sponsor or fiduciaries to unnecessary risk.

Cash-Flow Problems. The DOL recently released guidance with respect to who has a fiduciary duty under ERISA to pursue the collection of delinquent employer and employee contributions to an ERISA plan.[3] The DOL guidance arises in response to investigations that found instances in which trust agreements purportedly attempted to relieve trustees of any duty to collect delinquent contributions.

According to the DOL guidance, the collection of delinquent contributions is a fundamental trustee responsibility, even if it is not specifically delineated in the plan document. The responsibility may, however, be assigned to

- a plan trustee who maintains discretionary authority over the plan assets,
- a directed trustee who is subject to the direction of a named authority, or
- an investment manager.

If, however, an ERISA plan and trust documents do not impose a duty to collect delinquent funds on any fiduciary, then that duty will fall upon an employer and its board of directors to the extent plan documents relieve the trustee of the obligation to collect.

There is a serious problem with having an employer and its board bear the risk of collecting delinquent contributions—they have conflicts of interest and can be charged with prohibited transactions and personal liability as soon as delinquencies arise. Employer contributions are generally delinquent when they are owing to the plan and have not been transmitted in a timely manner, and employee contributions are delinquent if the employer fails to transmit them to the ERISA plan on the earliest date that such funds could reasonably be sent (and at the latest, 15 days after being withheld from employee pay).

Employers need to be careful to have their ERISA plans or trusts identify who has the duty to collect delinquent contributions (or, at least, not relieve the trustee of that duty). Further, lenders should beware of ERISA plan contribution arrangements that could thrust them into liability for interfering with an employer's duty to make required plan contributions.

Conclusion. Those under pressure to save corporate dollars should be alert to their ERISA fiduciary obligations, not only to protect plan participants but also to avoid liability for plan or participant losses. In its recent *LaRue* decision,[4] the U.S. Supreme Court recently opened the door for individualized recovery from defined contribution retirement plans, notably 401(k) plans. The message is clear for ERISA plan fiduciaries: whether you are dealing with plan funding or cash-flow, or vendor service contracts or fees, be sure to understand your ERISA obligations—and your risks, which run the gamut from criminal sanctions to personal liability.

[2] *See* 29 C.F.R. §§ 2550.408b; 2550.404a-5; 2550.404c-1; Revision of Annual Information Return/Reports, 72 Fed. Reg. 64,731 (Nov. 16, 2007). For discussion, see http://www.paulhastings.com/assets/publications/982.pdf?wt.mc_ID=982.pdf.

[3] DOL Field Assistance Bulletin 2008-1, Fiduciary Responsibility for Collection of Delinquent Contributions (Feb. 1, 2008).

[4] LaRue v. DeWolff, Boberg, & Assoc. Inc., 128 S. Ct 1020, 42 EBC 2857 (Feb. 20, 2008).

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