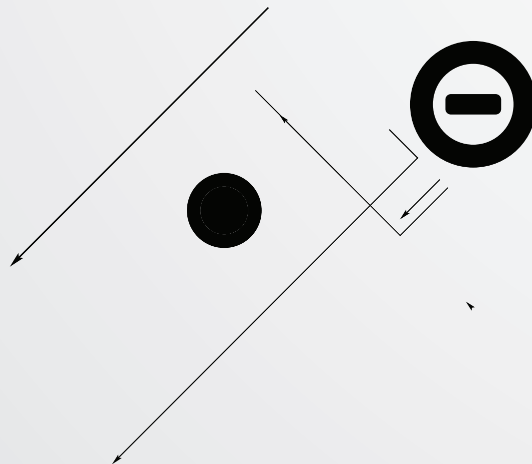
DOL'S **12 TIPS** FOR MONITORING SERVICE PROVIDERS

Monitoring service providers is a fiduciary obligation. Here's a closer look into how a list of 12 tips from the DOL can help.

By Mary Patch & David J Witz



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While the obligation under ERISA to monitor investments is well known and widely addressed, it is equally important to monitor all service providers. In fact, according to the courts, a failure to monitor service providers is a fiduciary breach of duty.[1]

This duty to monitor is described in 29 CFR §2509.75-8 (FR-17Q):

> "At reasonable intervals, the performance of trustees and other fiduciaries should be reviewed by the appointing fiduciary in such manner as may be reasonably expected to ensure that their performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan. No single procedure will be appropriate in all cases; the procedure adopted may vary in accordance with the nature of the plan and other facts and circumstances relevant to the choice of the procedure."

In addition to that regulation, the DOL has expressed the view that the duty to monitor is a fiduciary obligation that meets the general duty of loyalty and prudence standards imposed by ERISA §404(a)(1). We see this expressed by the DOL in a 1996 Interpretative Bulletin:

> "As with any designation of a service provider to a plan, the designation of persons to provide investment educational services or investment advice to plan participants and beneficiaries is an exercise of discretionary authority or control with respect to management of the plan; therefore, persons making the designation must act prudently and solely in the interest of the plan participants and beneficiaries, both in making the designation(s) and in continuing such designation(s)."[2]

Besides the Interpretive Bulletin, the DOL has also addressed the duty to monitor in an Information Letter stating that:

> "In choosing among potential service providers, as well as in monitoring and deciding whether to retain a service provider, the trustees must objectively assess the qualifications of the service provider, the quality of

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the work product, and the reasonableness of the fees charged in light of the services provided."[3]

While it is clear that ERISA does not establish any explicit due diligence monitoring standards, the DOL has issued "Tips for Selecting and Monitoring Service Providers for Your Employee Benefit Plan," which provides tips that would apply to monitoring the activities of any fiduciary or non-fiduciary service provider. However, it is important to recognize that these tips are not comprehensive, but rather represent a guideline that must be evaluated under the facts and circumstances specific to the plan and service provider. A review of the DOL's 12 tips along with appropriate questions that a responsible fiduciary should consider follows.

TIP 1: Consider what services you need for your plan – legal, accounting, trustee/custodial, recordkeeping, investment management, investment education, or advice.

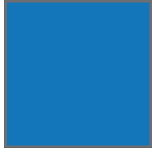
Legal
Confirm that legal counsel have expertise in Title 1 and 2 of ERISA.

Accounting/Audit
Confirm Accountant has extensive experience auditing retirement plans.

Trustee/custodial
Is directed or discretionary services desired? Does the custodian produce certified statements if an audit is needed? Is the custodian reputable and insured? Can the custodian hold the investments the plan holds (e.g., ETFs, mutual funds, CITs, separate accounts, stocks, bonds)?

Recordkeeping
Does the recordkeeper have extensive experience with the following?

- The plan's design (e.g., defined contribution, defined benefit, cash balance, 457, 403(b), ESOP, KSOP)
- Services that are important to employees (e.g., mobile access, multilingual support, call center, voice response system, online advice portal, retirement readiness tracking)
- Services that are important to administrative staff (e.g., online enrollment, distributions and loans, mailing



> While there is no requirement to select the lowest-cost provider, it is important to state the reasons why a higher-cost one is selected.

services, payroll integration, retirement readiness monitoring, and audit support)
- Compliance obligations such as required notices and testing
- Fiduciary support services such as those provided by an ERISA §3(38), §3(21), and/or §3(16) provider

Investment Management
Does the committee have the expertise and technology to accurately evaluate and monitor the investments? If not, does the advisor or investment manager have that expertise, and will they accept fiduciary liability as an ERISA §3(21) or ERISA §3(38) fiduciary? Are custom models or managed portfolios a desired service, and does the advisor have experience delivering those services? If so, can the recordkeeper accommodate the models and/or managed accounts? If the committee prefers target date funds as a QDIA, does the advisor have a documented process to select and monitor those funds based on DOL's guidance?

Investment Education or Advice
Has the committee determined which employee education topics and the method of delivery are most likely to assist employees to meet their retirement objectives, and can the service provider deliver those services? Is the service provider capable of implementing a retirement readiness program?

TIP 2: Ask service providers about their services, experience with employee benefit plans, fees and expenses, customer references or other information relating to the quality of their services and customer satisfaction with such services.

Provider Services
Does the provider offer bundled and/or unbundled services? Is a detailed list of specific services outlined in a service agreement provided so the committee may monitor whether promised services were delivered on time, accurately and professionally?

Experience
Does the provider have staff with the necessary experience, education and skill to serve the plan's administrative and operational needs as well as the best interests of plan participants? The committee should confirm years of experience working with similar plans, the number of plans they service, staff experience and designations, and continuing education protocols.

Fees and Expenses
Does the provider deliver a comprehensive §408(b)(2) disclosure that outlines all direct and indirect fees tied to services provided as well as the source of the fees paid? Does the provider offer flat fees? Are flat fees more competitive for the plan based on historical growth? Does the provider outline costs for ancillary services such as fund changes, plan transfer, distribution and loan fees, transition, hourly consulting, self-directed accounts, enrollment booklets, allocation calculations, Form 5500 filing and extensions, compliance testing, and employee education meetings?

References
The client should ask each service provider to provide references from existing and terminated clients.

TIP 3: Present each prospective service provider identical and complete information regarding the needs of your plan. You may want to get formal bids from those providers that seem best suited to your needs.

When the committee decides to conduct a formal Request for Proposal (RFP) – an event that should occur every 3 to 5 years depending on the size of the plan – the committee should consider retaining an ERISA consultant who is familiar with industry standards, service provider deliverables and pricing to assist with developing a comprehensive RFP and identifying the best candidates to fulfill the objectives of the plan.

TIP 4: You may also wish to consider service providers or alliances of providers who provide multiple services (e.g., custodial trustee, investment management, education, or advice, and recordkeeping) for a single fee. These arrangements are often called "bundled services."

Determining whether a plan should use a bundled or unbundled provider depends on many factors, some of which include plan complexities, "white glove" support, extensive nature of the vendor review, and disclosure of potential conflicts of interest associated with affiliated service providers. Here again, though not required, leveraging the expertise of an ERISA consultant is often the best solution for addressing those issues.

TIP 5: Ask each prospective provider to be specific about which services are covered for the estimated fees and which are not. Compare the information you receive, including fees and expenses to be charged by the various providers for similar services. Note that plan fiduciaries are not always required to pick the least costly provider. Cost is only one factor to be considered in selecting a service provider.

It is important to break down costs by services rendered to fully understand any direct or indirect fees (i.e., revenue sharing) that may be used to pay service providers. If indirect fees are collected by service providers, the committee should request a breakdown annually of the total amount received from each service provider and the service provided for those fees. The committee should be able to "follow the money" to determine whether fees are reasonable. Keep in mind that stable value and guaranteed investment accounts create their own challenges because the net return may be adjusted to reflect the payment of indirect fees. When an RFP is conducted, is it best to develop a side-by-side comparison of fees for services rendered to make an informed decision. Equally important is to document the reasons for the selection, especially if the winning provider is not the lowest-cost one. While there is no requirement to select the lowest-cost provider, it is important to state the reasons why a higher-cost one is selected.

TIP 6: If the service provider will handle plan assets, check to make sure that the provider has a fidelity bond (a type of insurance that protects the plan against loss resulting from fraudulent or dishonest acts).

Bonding is a requirement under ERISA §412 for anyone who handles assets. A committee will need to determine whether a provider is handling assets as well as the amount of the bond that the provider will need to secure. In addition, while it is not required by ERISA, the committee should confirm that their all providers carry first-party Error and Omission (E&O) insurance. The committee should pay attention to the amount of liability retained by the provider to ensure that the provider has the necessary capital to cover the deductible amount and whether the amount of coverage is reasonable given the size of the plan.

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TIP 7: If a service provider must be licensed (attorneys, accountants, investment managers or advisors), check with state or federal licensing authorities to confirm that the provider has an up-to-date license and whether there are any complaints pending against the provider.

A defensible due diligence process includes a review of a service provider's good standing with the state. If the committee is working with an advisor, review their Form ADV part 1 and 2 for any required disclosures and pull reports from the SEC and FINRA. (Also see www.adviserinfo.sec.gov/ and https://brokercheck.finra.org/.)

TIP 8: Make sure you understand the terms of any agreements or contracts you sign with service providers and the fees and expenses associated with the contracts. In particular, understand what obligations both you and the service provider have under the agreement and whether the fees and expenses to be charged to you and plan participants are reasonable in light of the services to be provided.

Determining whether fees are reasonable for services rendered is a fiduciary obligation under ERISA §408(b)(2). In addition, the committee will need to determine:

- Whether to pay fees directly, deduct them from employee accounts, or use indirect fees.
- Whether a service provider has acknowledged in writing to act as an ERISA fiduciary.
- Any liability the committee retains with respect to the provider selected.
- The cost of and notice requirements needed to leave the provider.
- Whether the agreed-upon services match the terms of the contract.

These objectives are best met with the help of ERISA legal counsel.

TIP 9: Prepare a written record of the process you followed in reviewing potential service providers and the reasons for your selection of a particular provider. This record may be helpful in answering any future questions that may arise concerning your selection.

ERISA imposes a fiduciary standard of procedural (the process) and substantive (the merits) prudence. This is best accomplished with proper documentation. The committee should retain the records from their review in their fiduciary file. This should include the analysis of services, vendor pricing analysis, and proposals presented to the committee along with minutes, reports, and notes regarding the vendor review process that was conducted.

TIP 10: Receive a commitment from your service provider to regularly provide you with information regarding the services it provides.

The committee should annually review each provider by comparing the services delivered to the services promised. The process should answer five key questions:

Services provided should be evaluated in light of any legislative, regulatory or judicial changes, as well as any technological or industry changes.

- Was the promised service delivered?
- Was it timely delivered?
- Was it accurately delivered?
- Was it professionally delivered?
- Was it delivered to your satisfaction?

In addition, any policies and written procedures should be reviewed annually to confirm that all services that were provided support the objectives outlined in those documents. Also, the services provided should be evaluated in light of any legislative, regulatory or judicial changes, as well as any technological or industry changes.

TIP 11: Periodically review the performance of your service providers to ensure that they are providing the services in a manner and at a cost consistent with the agreements.

Reviews should be conducted at least annually of the current fees paid compared with the prior year's fees for the services provided. As the plan assets grow, any asset-based fees associated with the plan should be reviewed to confirm that any increase in the dollar amount paid is reasonable and not excessive relative to the services provided.

TIP 12: Review plan participant comments or any complaints about the services and periodically ask whether there have been any changes in the information you received from the service provider prior to hiring (e.g. does the provider continue to maintain any required state or federal licenses).

This is not an ERISA obligation, but surveying participants for comments or complaints is a best practice to gauge the success of the retirement program.

CONCLUSION

The DOL does acknowledge that this list is a "starting point." That said, most sponsors will struggle to convert these tips into an effective process for monitoring without the assistance of an ERISA consultant. Of course, with or without such help, a committee, at a minimum, should demand that all retained service providers deliver a written service agreement that outlines fees assessed for services rendered. Without a written agreement, it is virtually impossible to measure and monitor a service provider – and, as noted above, a failure to monitor can lead to a breach of fiduciary duty under the general duties of ERISA §404(a)(1).

Keep in mind that the DOL emphasized the need to monitor in Interpretive Bulletin 94-2:

> "…compliance with the duty to monitor necessitates proper documentation of the activities that are subject to monitoring."[4]

And the DOL's position has been supported by more than one federal court:

> "…[t]rustees also have an ongoing obligation to monitor the fees charged and services provided by service providers with whom a fund has an agreement, to ensure that renewal of such agreements is in the best interest of the fund."[5]

Bottom line: monitoring service providers is a fiduciary obligation for all service providers, not just the ones that handle the investments. **PC**

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FOOTNOTES

1. See, ***Atwood v. Burlington Indus. Equity, Inc.***, 18 E.B.C. 2009 (M.D.N.C. 1994) (failure to monitor appointees leads to liability for breach of fiduciary duty).
2. **DOL Interpretive Bulletin** 96-1, 29 CFR §2509.96-1.
3. **DOL Information Letter,** Qualified Plan Services (July 27, 1998).
4. **DOL Reg.** §2509.94-2, Interpretive Bulletin 94.2 (July 29, 1994).
5. ***Liss v. Smith***, 991 F. Supp. 278, 300 (S.D.N.Y. 1998), citing *Whitfield v. Tomasso*, 682 F. Supp. 1287, 1304, 9 E.B.C. 2438 (E.D.N.Y. 1988).