Monitoring Your Service Provider

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It seems obvious, but it is such good advice that it must be repeated here: Know your plan! There is so much to know, of course, to comply with the fiduciary rules under the Employee Retirement Income Security Act of 1974 (ERISA) but also to ensure that best practices for retirement plans are being met and surpassed. The best way to accomplish both goals is ongoing due diligence . . . simply said, but complicated to achieve.

With that having been said, due diligence is best folded into day-to-day operations and fiduciary meetings in order to ensure ongoing compliance. In order to do so, the plan sponsor must be aware of the appropriate processes, laws and regulations, and red flags to perform the function properly. Many plan sponsors that have hired investment advisors then feel the need to hire another independent advisor to report to its fiduciary committee on the compliance and processes of the investment advisor. With so much litigation and significant funds invested in plans, one can understand why such a service is desirable . . . but is it necessary? The answer is not simple, and diving into some basic requirements first is appropriate.

We turn to, of all places, a patent infringement lawsuit for some guidance. Filed in August 2014, GRQ Investment Management (GRQ) filed suit against Financial Engines Inc. and Financial Engines Advisors in the U.S. District Court for the Eastern District of Texas, alleging the defendants infringed on a pair of patents. The defendants were in the business of providing personalized fiduciary advice to employees of its plan sponsor clients. GRQ claimed that two patents it owned were violated in a number of ways, including by providing a system for discretionary asset allocation and providing a method for distribution suggestions for investors. It took only until January 2015 for the GRQ to file for a voluntary dismissal

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with prejudice, but during that short five-month period, law firms throughout the county sounded alerts to the beginning of a flurry of suits against computer-based programs that provide investment advice to participants, as well as against plan sponsors and fiduciaries whose plans are utilizing programs that infringe on others' patents.

At the time, our esteemed legal counsel seemed like a prophet. He had warned us that the so-called "SunAmerica Opinion," an advisory opinion from the Employee Benefit Security Administration (EBSA) arm of the Department of Labor (DOL), would spark some issues because it stated that ERISA guidance from independent advisers could provide managed account services. The issue was what did it mean to us, a non-directed trustee investment advisor that selects funds on behalf of the plan sponsor, thereby assuming that fiduciary duty under ERISA?

The *GRQ* lawsuit thus proved yet another opportunity for us and many investment advisors to remind our clients that plan fiduciaries have a duty to prudently select third-party providers and their services, but relief from one fiduciary duty did not remove the duty to monitor investment performance, and also fees, investment selection processes, and more. A checklist for plan fiduciaries was quickly manufactured by many different sources, and many of them were appropriate guides for investment advisors to work with their clients to ensure their own and plan compliance. What follows is one such list of guidelines that fiduciaries consider in selecting and dealing with providers:

- Plan service providers are "parties-in-interest" under ERISA. The plan sponsor must therefore ensure that the involvement of any party-in-interest with the plan will not result in a prohibited transaction. The "parties in interest" of an employee benefit plan are: any fiduciary (including, but not limited to, an administrator, officer, trustee, or custodian), counsel, or employee of the plan; a person providing services to the plan; an employer of covered employees; a union whose members are covered; owners of such employers or employee organizations; relatives of a party-in-interest; or individuals or corporations with an ownership or employment relationship with a party in interest. The process then is first going through all of the parties to determine if any of them is a party-in-interest. If one is so found, the potential prohibited transaction must be reviewed.

- Professional advice to guide the provider selection process should be considered. This can happen when a plan sponsor hires an investment advisor, like Waterford, to take the fiduciary responsibility completely to select the investments, thus removing the plan from the process; the investment advisor's say is final, as is the assignment of fiduciary responsibility for the selection. The next level "up" is where a second fiduciary is hired to assist the plan sponsor in monitoring the investment advisor. In any event, the plan retains the ultimate responsibility of ensuring that these fiduciaries are doing their respective jobs.

- Before selecting plan providers, conduct careful due diligence as to their qualifications, experience, fees, expenses, client references and other factors bearing on the quality and appropriateness of their services. An online search should be made for any reported court decisions involving any potential provider. This duty does not end upon hiring, but instead must be continuous (in select intervals of time) to ensure that the providers remain qualified for their work. This should, but rarely involves, following up with client references, especially when a plan sponsor learns of an exodus from the provider.

- A request for proposal (RFP) or other formal bidding process for prospective providers may be appropriate. Subsequent RFPs including the already selected advisor are also appropriate, whether one is seeking to change or not. It not only keeps the current provider on its toes, but also ensures that the plan understands the competition including pricing and services.

- Even without a formal bidding process, complete details concerning the services to be provided and the fees charged must be obtained. Again, this is an ongoing process.

- Thoughtfully negotiate and periodically review provider contracts, including any indemnity obligations of both the provider and the plan administrator, particularly when the provider's form agreement is used. Often plans believe that a form that arrives via email in PDF format cannot be negotiated simply because it did not come as a Microsoft Word document . . . which may be exactly what the provider wants a client to believe, but that is just not so! As the plan fiduciary, it is critical to ensure that the agreement reflects necessary services and appropriate ERISA-compliant processes. Especially important is the ability to leave the provider! A contract that binds a plan to a provider without a short, reasonable way of separating is simply unacceptable. Therefore, the agreement should reflect not only a short window after notice until termination for any or no reason, it should also specifically state that the provider will cooperate fully with the transition. The agreement should also state that there are no separation fees, something that unfortunately has been a serious problem in the past especially with insurance companies that had placed insurance products within the plan that include surrender fees.

- Depending upon the authority over plan assets or plan administration that a provider is to be given as well as the services it is to perform, the provider may be a plan fiduciary. If so, the provider should acknowledge its fiduciary status in writing as well as the extent of the responsibility. In order to understand the full agreement, it should also spell out the plan's remaining fiduciary responsibility so that the next person sitting in the corporate chair, who may not be experienced in ERISA ways, will have the agreement as a "cheat sheet" spelling out duties and responsibilities for both the plan and provider.

- If the provider will handle plan assets, be sure a proper fidelity bond is in place. It is not enough to simply have the language in the contract, the plan should not be shy about asking for a copy of the bond for its records. Always keep in mind that it is prudent to think like a DOL auditor or better, a defendant in litigation: what document would you like to see and/or wish you had to defend the plan?

- Determine whether a provider's compensation is reasonable in light of the services being rendered. This is of special importance when the provider is to be paid by the plan, as reflected in the hundreds if not thousands of ERISA lawsuits currently being litigated throughout the country. For example, over 20 universities have been hit with class action lawsuits regarding the reasonableness of their fees, resulting in millions of dollars in settlements resulting from defendants' realization that litigation would be fruitless, that the fees being paid were simply too high. Some of the settlement agreements have been extremely specific with defendants settling forth the processes for benchmarking fees in the future. Remember, too, that the reasonableness of fees is an ongoing issue, and accordingly the benchmarking must be as well.

- Monitor provider performance and fees to be sure that proper services are provided and charges are consistent with the provider agreement. At the least this should happen semi-annually, although many prefer quarterly meetings. Boards of Directors have become much more interested in these results since the spate of lawsuits in the past decade that, despite having seemingly slowed a bit during the novel coronavirus (COVID-19) pandemic, have been a sore point not just for academic institutions but for many public companies as well.

- Follow up on any complaints about provider performance. This relates not only to investment performance, but such issues as Web sites, follow-up with employees, appropriate information given during one-on-one meetings . . . in fact, any connection between a provider and a participant or beneficiary. The result is often that the interaction that caused the complaint is not a fiduciary, but with enough dissatisfaction and a motivated unhappy participant, it is not a huge step to find a lawyer willing to attack something else in the plan.

- Document the steps that have been taken to select and monitor each plan provider, the services it is performing, and other matters related to investigation and decisions on provider issues. While it used to be a standard that process and not results will keep a fiduciary safe from potential liability under ERISA, we believe that is no longer the case. That is, the results have to reflect a higher standard in the past. It is rare today for fees to be acceptable if too high based upon the various providers and methods available for diversifying investments. Needless to say, a fiduciary must not only get the process right, but in turn must act accordingly in order to satisfy the evolving ERISA standard, and certainly to attempt avoidance of lawsuits.

We began this article by saying that the fiduciary duty to oversee providers is an ongoing duty; we close by saying the duty continues to evolve, and the standard only climbs higher. Expectations of the plan should grow in lockstep . . . and the appropriate provider will lead the way to higher and better methods for doing so. Anything less is simply unacceptable.