

Dispelling the Myth: Is a 3(16) Fiduciary Really Necessary?



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Dispelling the Myth: Is a 3(16) Fiduciary Really Necessary?

While discussions of fiduciary responsibility for retirement plans is not new, the latest trend circulating is that hiring an “independent” ERISA Section 3(16) fiduciary relieves an Employer of all fiduciary liabilities for their plan. Even though an employer may hire various service providers to assist with the operation and management of their plan (including but not limited to, the investment platform, financial advisor and Third Party Administrator), it typically retains primary fiduciary responsibility as the named “Plan Administrator” in the plan document and is never completely free of liability. Third Party Administrators and Recordkeeping firms (collectively “TPAs”) that market themselves as 3(16) fiduciaries are offering to limit an employer’s fiduciary burden (note that I said “limit”, not remove) by taking on some of the required functions with which the Employer as “Plan Administrator” is charged.

So, let’s start with identifying the responsibilities of a “Plan Administrator”:

1) A **“Plan Administrator” must be named in the plan document.** Generally if a specific company, or individual, is not named this role falls to the Plan Sponsor (i.e., the Employer).

2) A **“Plan Administrator” manages the plan’s Investment Menu.** Plan Administrators are responsible for investment selection and monitoring. They can choose to hire an ERISA Section 3(21) investment provider who will monitor current funds and make recommendations on fund selection. Hiring a 3(21) fiduciary gives a Plan Sponsor with little investment education the expertise to make prudent decisions with respect to the investments in the Plan. However, a 3(21) investment provider is not making the actual selections. At best they have co-fiduciary responsibility with the Plan Sponsor. Alternatively, a Plan Administrator can hire an ERISA Section 3(38) investment advisor who has full discretionary authority over the management and selection of the funds, including fund replacements. Note that the Plan Administrator is still responsible for monitoring the selection of the 3(38) provider.



3) A **“Plan Administrator” oversees the administration of the plan.** These duties generally fall into five main reporting and disclosure categories:

a) *Maintain and interpret the plan document and oversee plan operations.* This includes keeping the plan document up to date for all required changes; reviewing and interpreting plan provisions related to eligibility, contributions and earnings allocations; benefit distributions and participant vesting; and performing all required compliance tests.

b) *Provide all required disclosures to plan participants.* This includes distribution of the Summary Plan Description, Summary of Material Modification, Summary Annual Report, Participant Fee Disclosure Notice, Safe Harbor Notice, Qualified Default Investment Alternative Notice, and Automatic Enrollment Notice when due.

c) *Provide benefit statements to participants.*

d) *Comply with all required governmental reporting.* This includes preparation of the Form 5500 and Form 8955-SSA; selecting the audit firm to prepare any required attachment to the Form 5500 filing; and preparing and filing Forms 945, 1096 and 1099-R related to plan distributions.

e) *Ensure timely deposits of contributions into participant accounts.*

4) A **“Plan Administrator” engages service providers.** Plan Administrators may outsource some of the plan functions to outside providers. However, it must oversee the performance of such providers and monitor the reasonableness of fees.

What does a 3(16) service provider do?

Firms offering 3(16) services purport to accept responsibility for one or more of the above duties of the “Plan Administrator” for a fee, often based on the size of the plan or amount of plan assets. Some TPAs now claim to provide 3(16) services for the plans they administer for an additional cost. Like any other service contract, fees for 3(16) services will vary depending on the services provided. (Generally I have seen these added services marketed to cost anywhere from 5 to 50 basis points on plan assets, i.e., \$2,500 to \$25,000 for a plan with \$5,000,000 in assets.) Very few firms offering 3(16) services will actually go as far as being named the “Plan Administrator” in the plan document, which means that they are limited to taking on 3(16) responsibility only for the areas that are indicated in their contracts, and the Employer as Plan Administrator retains responsibility for administering all other plan functions, plus monitoring the prudence of the 3(16) selection.

To monitor the prudence of the 3(16) selection an Employer needs to elicit information and evaluate:

- 1) The qualifications of the service provider;
- 2) The quality of services provided;



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- 3) The potential for conflicts of interest between the 3(16) provider and any other outsourced plan service providers the Employer may use;
- 4) The reasonableness of the provider's fees in light of the services provided;
- 5) Any caveats to the 3(16) contract that limit the fiduciary responsibility of the service provider; and
- 6) The provider's capacity to pay any possible legal claims made by the Employer or its participants in connection with any breach of 3(16) duties to the Plan.

I mention the caveats to the contract since 3(16) contracts typically contain many disclaimers. Because most of the administrative functions that a 3(16) service provider may offer to take on for the Employer are conditioned on receiving timely and correct payroll and census information, it is easy for a 3(16) provider to contractually limit its own liability for services when the 3(16) provider does not control the payroll or human resource functions for the Employer.

Is there a real value?

The truth is that Employers cannot avoid fiduciary responsibility and potential liability under ERISA by simply retaining an "independent" provider. The mere act of hiring the outside provider is itself a fiduciary function. Simply put, a fiduciary's failure to monitor a third party's performance, and failure to terminate them for non-performance, is a breach of fiduciary duty under ERISA. Selecting and monitoring a 3(16) provider can itself be challenging and the Employer may ultimately be liable, i.e., end up holding the bag, for the misdeeds and/or negligence of the 3(16) provider if the provider was imprudently selected; if the employer could or should have known about a possible breach of duty; or if the 3(16) fiduciary doesn't have sufficient assets to pay any claims that arise.

Conclusion

TPAs that service retirement plans are usually already engaged to provide assistance to the Plan Administrator for many of the responsibilities described above. However, the Employer is always ultimately responsible for ensuring that the payroll and census data given to the TPA is accurate. Assuming that the Plan Administrator provides good data, a competent TPA should provide comprehensive, timely and technically accurate services to the plan. Tacking on the term "3(16) fiduciary" to the service contract and charging additional service fees does not mean that the TPA has magically removed the liability of the plan from the Plan Administrator, particularly when the TPA can claim that any mistakes they make are caused by bad or untimely data provided by the Employer. The better alternative for most Employers would be to prudently



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manage their plan on their own and seek technical assistance from quality service providers that are not providing 3(16) services (thereby avoiding the cost of the 3(16) services). Purchasing good quality Fiduciary Liability Insurance (which typically costs \$1,000 to \$2,000 for \$1,000,000 worth of coverage) will help the Plan Administrator in the event it inadvertently fails to perform any of its fiduciary functions.

At Retirement Management Services (RMS) we have the technical expertise to help you prudently manage your plan. We help Plan Sponsors manage their 3(16) fiduciary duties by providing all of the following as part of our services:

1. Maintain and Interpret the Plan Document and Assist with Plan Operations

- ✓ RMS prepares the plan document required to establish a Plan
- ✓ RMS coordinates with the Plan Sponsor on all required amendments
- ✓ RMS provides sample Loan Policies/Procedures for the Client (if required)
- ✓ RMS provides sample Qualified Domestic Relations Orders Policies/Procedures (if required)
- ✓ RMS can assist in interpreting plan document provisions
- ✓ RMS will review the determination of eligible participants (based on information provided)
- ✓ RMS reviews all distribution requests for vesting, proper documentation, and validity of benefits under the terms of the Plan and notifies the Plan Sponsor if any distribution does not meet ERISA standards
- ✓ RMS can prepare contribution or earnings allocations for the Plan Sponsor
- ✓ RMS determines who is a Highly Compensated or Key Employee for testing purposes (based on the information provided)
- ✓ RMS prepares all required compliance and nondiscrimination testing for the Plan, including overall deduction limits, individual limit monitoring, coverage and participation testing, and top heavy testing.

2. Assist Plan Sponsors with All Required Disclosures to Plan Participants

- ✓ RMS provides Summary Plan Description for participants as required
- ✓ RMS prepares Summary of Material Modifications as required
- ✓ RMS prepares the annual Summary Annual Report for distribution
- ✓ RMS assists the Investment Company and Investment Advisor with preparation of Participant Fee Disclosure notices under 404(a)(5) and any Qualified Default Investment Alternative (QDIA) Notices
- ✓ RMS prepares the annual Safe Harbor Notice or Automatic Enrollment Notice



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3. Provide Plan Sponsors with Benefit Statements

- ✓ RMS provides participant statements for Trustee directed plans and Self-Directed Brokerage Accounts

4. Comply with Governmental Reporting

- ✓ RMS prepares a signature ready Form 5500 filing for the Plan Sponsor
- ✓ RMS prepares a signature ready Form 8955-SSA filing for the Plan Sponsor
- ✓ RMS prepares comprehensive audit packages and assists the auditor (for plans over 100 participants)
- ✓ RMS prepares all required tax reporting for Trustee directed plans and Self-Directed Brokerage Accounts including Forms 945, 1096 and 1099

5. Ensure timely deposits of contributions into participant accounts

- ✓ RMS regularly reminds the client of the timing rules



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