

# 3(16) and the Fiduciary Plan Administrator: The Next Number to Decode

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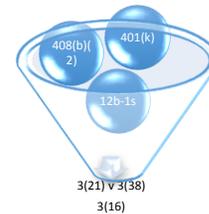
President and ERISA Counsel



In this increasingly high risk regulatory environment, plan sponsors are seeking new ways in which they can delegate to others some of their ERISA fiduciary responsibilities. Included among them is authorizing another to assume decision-making authority for plan administration duties. These functions have traditionally been the sole purview of plan sponsors. Any service provider rising to the challenge to accept fiduciary plan administration accountabilities - and the resulting liability that goes with them - will wish to carefully consider exactly what duties he or she is capable of performing and what additional risks they present. First a little background.

### Demystifying a Language of Numbers

ERISA-speak can be difficult for the un-initiated. Communicating involves a language based on numbers, founded in distinct bodies of law. Practitioners deftly refer to 401(k) plans (a tax code provision), 408(b)(2) section of ERISA dealing with prohibited transactions) 12b-1s (an Investment rule) and the differences in 3(21) and 3(38) services. Added to this is now 3(16) clarity can be gained from knowing that Section 3 of Title I of ERISA includes the in the act and the 16<sup>th</sup> definition is that of “plan administrator.” Hence, when these performed by another, they are called “3(16) Services.”



disclosures (a Company Act services. Some definitions used services are

The plan administrator is either named in the plan document or, if none is named, employer is presumed to have this role. The plan administrator is automatically considered a plan fiduciary. As a fiduciary, a plan administrator who breaches his or her duties faces severe penalties. A fiduciary can be:

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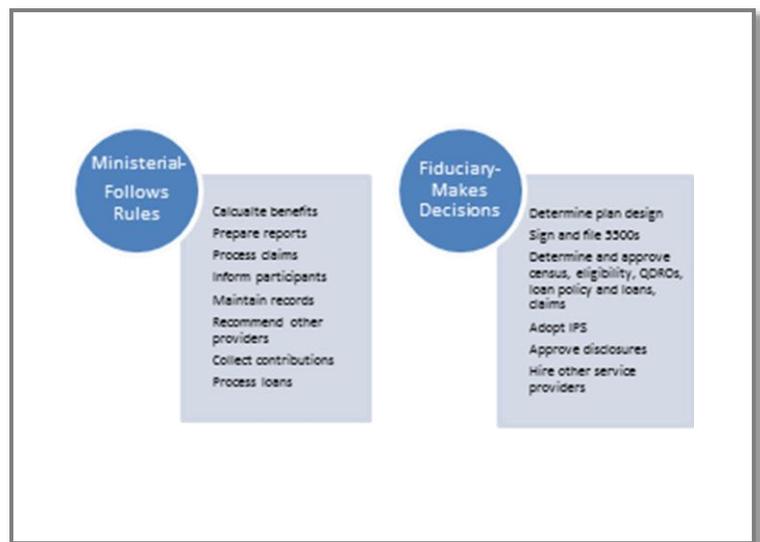
- Personally liable for losses suffered by the plan and lost opportunity costs.
- Required to pay attorney fees.
- Subject to Department of Labor fines or IRS excise taxes.
- Liable for breaches of other fiduciaries.

### Ministerial v Fiduciary?

The plan administrator is the big “A” administrator. It is not to be confused with a third party administrator (“TPA”). The plan administrator has a wide variety of responsibilities.

Some of the major categories include: plan qualification and operations; retaining experts; reporting and disclosure; investments and expenses; making contributions, overseeing distributions and recordkeeping; and determining plan coverage, discrimination testing and tax reporting.

The plan administrator makes real decisions about managing the plan and is therefore a fiduciary. He or she might outsource some of the routine operations to a non-fiduciary, such as a TPA. The TPA’s functions are “ministerial” only, meaning that the TPA simply follows rules while the administrator uses its discretion to make decisions, such as adopting and interpreting policies and establishing rules of operation. The TPA may simply follow the rules when calculating benefits, preparing reports, processing claims or collecting contributions. The administrator is charged with actually making those contributions in the proper amount and on time, resolving claims disputes and signing reports.



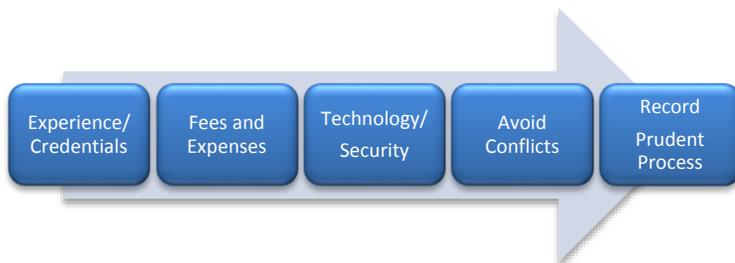


### How to Shift Fiduciary Authority

By appointing a service provider to as a 3(16) fiduciary, the employer, who is typically the original plan administrator, can shift responsibility for some fiduciary decisions from itself to the provider. This can be accomplished only if the plan document provides a procedure for the administrator to appoint another fiduciary or a procedure to allocate its duties among the other fiduciaries. This can work for all but trustee functions such as asset management duties, which require a special type of appointment. Anyone wishing to convey or accept these fiduciary duties is cautioned to seek the advice of a skilled attorney to make sure that this is accomplished properly. If it is not, responsibility remains with the original administrator.

This is not a free walk away, however, as some fiduciary responsibilities can never be escaped. The employer must conduct proper due diligence in selecting the provider and provide oversight to remain confident that the services are being appropriately delivered.

Plan sponsors can enlist the help of a prospective service provider by asking them to provide the right information that documents the plan sponsor's due diligence process. This information will help create an audit-ready file that the sponsor followed a prudent fiduciary process when selecting and retaining you.



### Deciding What Duties to Assume

Generally, plan sponsors are looking for help that will save them time, limit staff and avoid liability. In deciding whether to assume duties that will meet those goals, a provider will assess how the resulting fiduciary risk can be controlled or mitigated. This is largely a determination of whether the provider has the necessary information, expertise and resources. For example, providers typically are not in control of whether payroll is timely paid and therefore whether salary deferrals are timely contributed to the plan. They likely will not wish to take on fiduciary responsibility for depositing plan contributions. Alternatively, a provider that is already processing claims and producing operations manuals for plans may be comfortable also making the final claims decisions and being responsible for adopting the policy manuals. Approving the final census might best be left in the HR department's hands because a service provider may have difficulty confirming every employee who is eligible to participate. Each of the services must be carefully risk-assessed.

Key among the considerations is whether any particular service presents a conflict of interest for the fiduciary administrator. A fiduciary may not use his or her authority to gain additional compensation or engage in self-dealing. The 3(16) cannot, therefore, appoint him or herself the 3(38) investment manager and then get paid more.

### Pricing Services

TPA services offer a wide variety of fee structures. Separate charges can be assessed for each and every transaction, such as each loan approved, disclosure provided, QDRO processed, etc. This might be viewed by the employer as "nickel and diming." Alternatively, an asset based fee grows with the assets, and presumably with the required amount of service. The Department of Labor is beginning to question whether this is really true. Combinations of fees can be bundled into a single program. In each case, the risk to the provider, and the commensurate compensation, rises with the level of assets, the volume of individual transactions and the errors and omissions risk.



### Are Your Providers Covered?

Most errors and omissions coverage requires a special endorsement for fiduciary administration. It is critical for the provider to work with a broker knowledgeable in this area to find the right coverage. Fiduciary liability coverage should also be obtained. Do not forget also that the plan administrator likely “handles” plan assets and should be covered by an ERISA fiduciary bond.

### Contracts

The primary purpose of any contract is to document what each party agrees to do. Disputes are more easily avoided if it is very clear who will be doing what. A check-the-box menu format is a great method to list easily understood descriptions of the services offered and a clear way for the plan sponsor to precisely indicate which services have been selected. Failure to check a box should be an express representation that the service provider is not performing that unchecked service, avoiding confusion- and possibly legal fees- down the road. Affirmatively state what the service provider will *not* do.

Strive for Plain English. A good lawyer today should be able to write in words that the parties to the agreement can actually understand. The contract should serve as a guide to the parties for which the reader should not have to translate from “legalese.” For a complete article on “ERISA 3(16)-Top 10 Provisions to Include in a Well-crafted Service Agreement”, visit the NAPLIA website at <http://www.naplia.com/316/ERISA-316-provisions-service-agreement-KSE.pdf>.

### Beware of Newest Shiny Object



The buzz about 3(16) services is getting louder. It is likely that these services may one day be as commonly known as 3(38) services are today. Until routines are established, it is wise to Beware of the Newest Shiny Object. Do your homework and understand that this is not for every provider. Any good service is based upon firm grasp of the required technical know-how, systems and procedures. As in all things relating to administration, it is about Process, Process, Process.

### About the author:

Kim Shaw Elliott is President of IFP Plan Advisors, a division of Independent Financial Partners (“IFP”), a registered investment advisor. Kim helps investment advisors and their plan sponsor clients successfully navigate the complex rules founded in ERISA/employee benefits, securities law, broker dealer regulation and tax. She defines IFPs risk management strategies for retirement programs, provides thought leadership and training, and delivers solutions-based guidance to support IFP’s advisory business. She also serves as the firm’s ERISA counsel.

A three-time graduate of Washington University in St. Louis, Kim earned her JD, LLM, and executive MBA there. Her bachelor’s degree in Mass Communication- Radio Television was awarded by Southern Illinois University at Edwardsville. She holds the Fellow, Life Management Institute and Associate- Customer Service designations. Kim is a frequent speaker on employee benefits and securities-related topics.

