Selecting and Monitoring Retirement Plan Service Providers:

What Is a Prudent Fiduciary To Do and How Can Your Advisor Help?

Previously

This is the third and final installment in a series of articles concerning the delivery of services to retirement plans. In the first report, we examined the question of who is a 3(21) versus a 3(38) investment fiduciary. Last time, we looked at the three traditional models for how investments are delivered to retirement plans and when it is preferable for a plan sponsor to use each type. We now consider what due diligence measures can be followed in making that selection.

Introduction

A retirement investment professional, by nature, provides particular services for the plan recipients. How does the plan sponsor select the provider of those services? What standards apply? Once hired, what happens next?

As a consumer of retirement services (*i.e.*a plan sponsor), it is important to understand best practices for selecting providers. It is equally as important for any service provider to understand what process is used to evaluate their own services. Service providers who understand the selection process can demonstrate extra value to potential clients by helping them understand

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what is required to conduct a sound, prudent fiduciary process. This can be bewildering to an otherwise very sophisticated business leader if his or her main business is, say, building widgets and not managing a retirement plan.

Why is this important? Hiring a plan service provider in and of itself is a fiduciary activity. Any plan sponsor is automatically considered a fiduciary; he or she must act prudently when selecting service providers and follow a sound process that is well-documented. Having evidence of a good process both supports good decisions and mitigates risk. Just as importantly, a well-documented process saves time when initiating the search for the service provider.

Standards

The plan fiduciary is subject to the "prudent expert" standard, meaning that he or she must conduct the operations of the retirement plan as any expert would. If he or she lacks that expertise, the fiduciary must hire someone who does. Once selected, the plan fiduciary cannot simply turn away but must also monitor the performance of the service provider.

Ultimately, it is the fiduciary who is at risk for the quality of the services provided. If the fiduciary is uncomfortable with having this responsibility all alone, he or she can seek out providers that are willing to share fiduciary responsibility, such as a 3(21) investment advisor or a 3(38) investment manager. (See prior reports for more detail.) Some providers, such as third-party administrators (TPAs), might even be willing to serve as a 3(16) plan administrator, meaning that they take on fiduciary decision-making authority for selecting other providers or making decisions about the operation of the plan.

Here are some suggestions for how a plan sponsor might approach the decision making process:

1. Determine what services meet the needs of the plan. Begin with an internal and personal self-assessment of the plan sponsor:
   - What are the overall plan objectives?
   - How prepared are individuals in the firm to make prudent decisions for their employees?
     - What is the fiduciary's personal investment experience?
     - What is the experience of other internal colleagues who may participate in the decision making process?
     - What expertise do the internal staff members lack, and what type of professional expertise would fill those gaps in accordance with the firm's risk tolerance?
       - What is the professional investment experience of the chosen service provider? Is he or she acting in a fiduciary capacity?
       - How much personal risk is the investment professional willing to assume for making the ongoing investment decisions?

2. Beyond simply choosing what investments to offer, consider other fiduciary responsibilities:
   - How comfortable is the plan fiduciary in reviewing service arrangements and disclosures to determine if the compensation, and the services themselves, are appropriate to meet the needs of the plan?
     - Will the fiduciary know how to review the disclosures provided by the service providers for both proposed and existing arrangements? The disclosures should describe the services to be performed, detail all direct and indirect compensation to be received, and help identify any conflicts of interest.
     - Does the fiduciary understand the compensation structure, know all fees and expenses and how they are charged?
   - Is the fiduciary aware of what alternatives are available in the marketplace so that he or she can make good comparisons?
3. Conduct due diligence on prospective service providers so that you may review and document information about:
   - The firm itself, its financial condition, and its experience with retirement plans of similar size and complexity;
   - The quality of the firm's services;
   - The identity, experience, and qualifications of professionals who will be handling the plan's account;
   - Any recent litigation or enforcement action that has been taken against the firm;
   - The firm's overall experience or performance record; and
   - The firm's fiduciary liability insurance coverage.
4. Conduct a formal review process at regular intervals, often quarterly, to decide whether to continue with or replace a service provider by:
   - Evaluating any notices about possible changes to the service provider's compensation;
   - Reviewing the service provider's own performance and the investments they provide or recommend;
   - Reading any reports they provide;
   - Checking actual fees charged;
   - Asking about policies and practices (such as trading, investment turnover, and proxy voting); and
   - Following up on participant complaints or inquiries.
5. Check the plan document to ensure that all activities conform to what is written and required in the plan.

Conclusion - It Takes a Team

Any service provider a plan sponsor selects becomes part of a valuable team, joining other service providers, the sponsor, its internal personnel and its lawyers. Service providers may help the plan sponsor and increase their own value by helping clients understand and meet their very important fiduciary responsibilities.

Additional Resources

Tips For Selecting And Monitoring Service Providers For Your Employee Benefit Plan, available at: http://www.dol.gov/ebsa/newsroom/fs052505.html. (Note: this is a great resource, providing what is really a step-by-step checklist to conduct your selection and monitoring process.)

Meeting Your Fiduciary Responsibilities, available at: http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html.

Selecting And Monitoring Pension Consultants - Tips For Plan Fiduciaries, available at: http://www.dol.gov/ebsa/newsroom/fs053105.html

About The Author

Kimberly Shaw Elliott represents broker dealers, investment advisers, insurance companies and others nationwide, providing in-the-trenches counsel about how financial organizations deliver services and products to investors, including retirement plans, as well as general securities compliance and regulation. Her practical guidance helps clients successfully navigate the complex intersection of rules founded in ERISA/employee benefits, securities law, broker dealer regulation and tax, with a focus on fiduciary responsibility.

Kim is a three-time graduate of Washington University in St. Louis, having earned her JD, LLM, and executive MBA there. She holds the Fellow, Life Management Institute designation, is a member of the Compliance and Legal Division of the Securities Industry and Financial Markets Association, was named President Emeritus of the Association of Corporate Counsel (St. Louis), chaired the Employee Benefits Committee of the Missouri Bar, and is a frequent speaker and author about employee benefits and securities-related topics.

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