Damitz Brooks Nightingale Turner Morrisset

Benefits in Brief

News and Insights for HR Executives, CFOs and Professional Administrators — Fall 2018

Hiring an ERISA 3(16) Administrator
Does This Relieve You of Fiduciary Duties?

In recent years, many employee benefit plan sponsors have hired independent ERISA 3(16) administrators in an effort to divest themselves of plan administration responsibilities.

This can be a smart move for sponsors who don't have an in-house expert who is well-versed in all the details and nuances of ERISA compliance. However, it's important to remember that outsourcing plan administration does *not* relieve sponsors of their fiduciary duty, as some sponsors mistakenly believe.

Plan Administrator Responsibilities

According to ERISA Section 3(16), an employee benefit plan administrator is responsible for daily operations of the plan and for signing the annual Form 5500.

The plan administrator should be identified in the plan document. If the document is not specific in naming an administrator, the plan sponsor is considered to be the administrator from a 3(16) fiduciary perspective. The specific responsibilities of the plan administrator as detailed by ERISA Section 3(16) include the following:

1. Managing the plan's investment menu. This includes investment selection and monitoring. As a sponsor, you can hire an ERISA Section 3(21) or an ERISA Section 3(28) investment provider to monitor funds and make investment recommendations if you don't have the necessary education and expertise.

2. Overseeing plan administration. This includes maintaining and interpreting the plan document, overseeing plan operations, providing benefit statements and required disclosures to participants, ensuring timely deposit of participants' contributions into their accounts, and complying with required government reporting.

3. Engaging plan service providers. If you outsource some plan functions to one or more service providers, you must oversee their performance and monitor their fees to ensure that they're reasonable.

Limitations of 3(16) Administrators

Independent ERISA 3(16) administrators may accept responsibility for one or more of these duties. Their fee is usually based on the size of the plan or the amount of plan assets. However, independent administrators generally will *not* agree to be named the plan administrator in the plan document or to sign Form 5500.

In other words, they only take ERISA Section 3(16) responsibility for the duties that are detailed in their contract. You as the plan sponsor would retain responsibility and fiduciary liability for administering all

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Your Plan's Recordkeeping Services

Get the Most Out of This Vital Relationship

As a plan administrator or sponsor, you have a fiduciary responsibility to closely monitor contracts with any outside service providers you use, including your plan recordkeeper. Specifically, you must ensure that the plan complies with the plan document and all ERISA and DOL rules and regulations.

Maximize Recordkeeping Services

When monitoring controls to evaluate recordkeeper contracts, consider the following suggestions for getting the most out of your plan's recordkeeping services:

Understand the terms of your service contract. Make sure you're taking full advantage of all services that are included in your recordkeeping contract. Also, be sure you understand what services are *not* included in the contract so you have procedures and controls in place to cover them.

For example, while the recordkeeper might apply loan payments to participant loan balances, he or she may not be responsible for reconciling loans or keeping track of loan defaults.

Determine the scope of your recordkeeper's services. Your recordkeeper may or may not provide plan advisory services and be the custodian of plan assets. It's important to understand all these relationships and the scope of services that your recordkeeper provides. You may decide to engage a separate plan advisor if your recordkeeper does not provide these services.

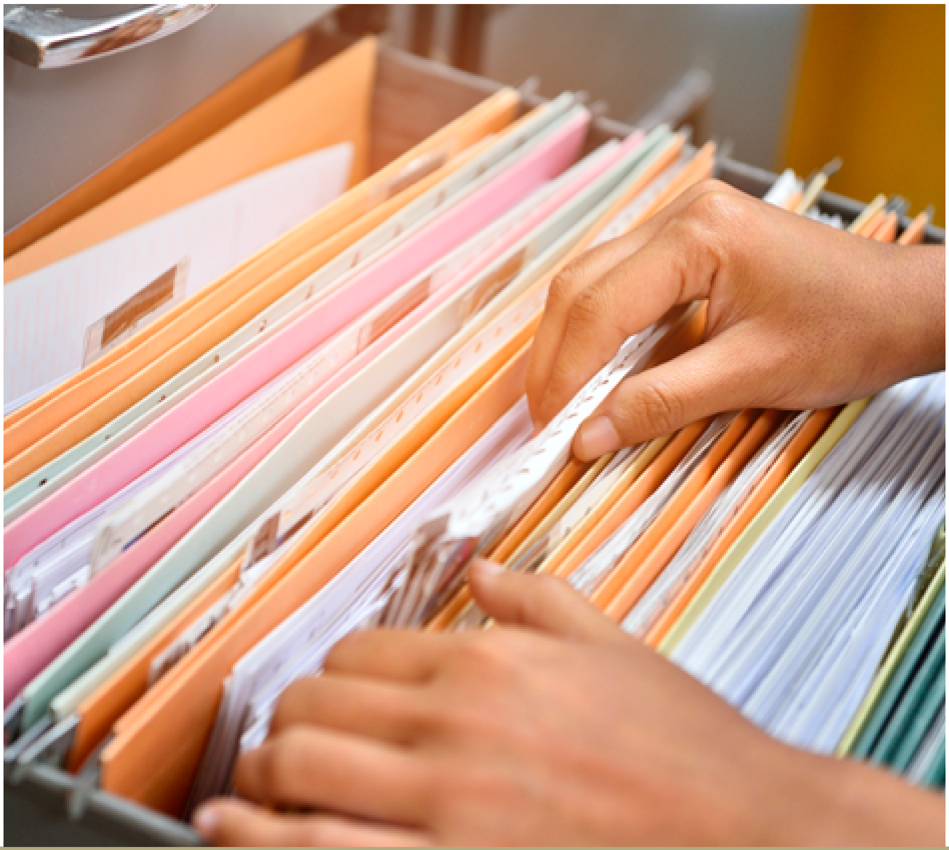
Take advantage of co-fiduciary responsibility if your recordkeeper offers it. While this does not alleviate your ultimate responsibility as the plan administrator, it may be important to your plan's structure and system of compliance controls. It may also provide an added level of comfort for plan trustees.

Obtain a SOC 1 report. This report details the scope of the recordkeeper's systems and focuses on the complementary user controls that should be in place at your organization. Ask your recordkeeper for a SOC 1 report every year, and make sure the complementary user controls are functioning as part of your annual plan monitoring procedures.

Ask about the recordkeeper's preferred timelines for obtaining information. Recordkeepers need to obtain a wide range of information from plan sponsors to ensure timely processing and reporting. Establish a timeline for your staff to submit information to the recordkeeper, and review reports throughout the year to make sure you're in compliance with ERISA and DOL regulations.

Complete the census report accurately and on time each year. Much of compliance testing and reporting that recordkeepers perform is triggered by and utilizes information from the census report. The census report also plays a critical role in plan audits, such as selecting samples for testing participant data and eligibility. Therefore, make sure you understand what to include in this report.

Understand and utilize recordkeeper reports. Recordkeepers provide monthly, quarterly, and annual reports to plan sponsors. You should use this information as part of your system of internal controls over financial reporting and compliance. This helps you identify operational errors and prohibited transactions before your annual plan audit so you can make corrections as soon as possible.



Reexamine the Relationship

The relationship with your plan recordkeeper is one of the most important ones you have with any outside service provider. It's smart to reexamine this relationship from time to time to make sure you're getting the most out of it.

Give us a call if you'd like to discuss your plan's recordkeeping services in more detail.

What Are Your Fiduciary Responsibilities?

As our lead article in this issue explains, you can hire an independent ERISA 3(16) administrator to handle a wide range of employee benefit plan administrative duties. The administrator can assume some, but not all, 3(16) fiduciary responsibilities.

However, there are certain duties that you as the plan sponsor must retain. These include the following:

1. Timely remittance of employee deferral contributions. Each pay period, you must remit deferral contributions withheld from employees' paychecks in a timely manner. This is defined as, "as soon as amounts can be reasonably segregated from the company's general assets, but no later than the 15th business day of the month following the pay date."

You should determine the number of business days it takes to process remittances and stick with this each pay period. Given the automated nature of the process, many plans are expected to remit contributions within a day or two of withholding.

2. Reconciliation of deferral contributions remitted each pay period with Form W-3. At the end of each year, total remitted contributions should equal total deferrals on your company's W-2 summary (or Form W-3). Investigate and reconcile any discrepancies. Report any late or missed contributions, and remit them as soon as possible.

3. Correct calculation of eligible compensation as defined by the plan. Eligible compensation is defined in the plan document and adoption agreement. Make sure you understand your plan's definition and educate payroll and HR personnel about the importance of adhering to it. Also monitor any changes in your payroll systems for proper coding.

4. Deduction of proper deferral amounts from paychecks. You are responsible for ensuring that employee elections for 401(k) deferrals are properly withheld from their paychecks.

Assign specific personnel to receive election forms or feedback information from the plan's recordkeeper and update payroll data in a timely manner. It's usually a good idea to have a second employee review election changes for accuracy.

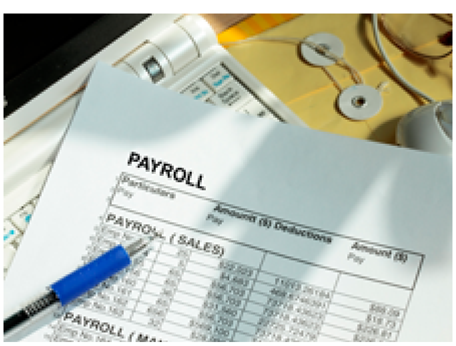
5. Compilation of timely and accurate census data. The plan is required to complete non-discrimination testing each year using census data for all employees with wages during the year. While the testing is typically performed by the plan's recordkeeper, the sponsor must ensure that demographic data (e.g., birth, hire, and termination dates), gross compensation, number of hours worked, and employee and employer contributions are accurate.

Meanwhile, you should compile and remit census data to the plan's recordkeeper no later than mid-February each year for calendar plan years.

6. Administration of participant loans. When participants make loans from the plan, you are notified of the amount and repayment terms. You can then set up repayments via payroll deductions in your payroll system.

Make sure that deductions for repayments begin and end in accordance with the loan terms and that employee deferrals are stopped for six months in accordance with the plan's loan policy.

Given their importance, you should designate a responsible employee or committee to oversee and monitor these activities.



Hiring an ERISA 3(16) Administrator

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other plan duties, as well as monitoring the prudence of the Section 3(16) administrator selection.

To do this, you need to evaluate such factors as:

- The 3(16) administrator's qualifications and the reasonableness of fees charged
- The quality of services the 3(16) administrator provides
- The potential for conflicts of interest between the 3(16) administrator and any other outsourced service providers you use
- The capacity of the 3(16) administrator to pay any legal claims that may arise in connection with a breach of 3(16) plan duties

You should also look carefully at the contract to see if there are any caveats that limit the 3(16) provider's fiduciary responsibility. Most of the administrative duties the provider takes on are conditioned on receiving timely and accurate payroll and census data. Therefore, providers usually seek to limit their liability if they don't control the generation of this data.

The Bottom Line

As a plan sponsor, you cannot avoid fiduciary responsibility and potential ERISA liability simply by hiring an independent ERISA 3(16) administrator. Such an administrator does not possess the data and authority needed to act in a full-scope Section 3(16) capacity.

In fact, the very act of hiring an independent administrator is a fiduciary function. Failure to monitor the 3(16) provider's performance—and terminate the provider if performance is sub-standard—is a breach of ERISA fiduciary duty.

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How to Evaluate Target Date Funds

Target date funds (TDFs) are one of the most popular investment options for defined contribution plans. If your plan currently offers or plans to offer these funds, you should carefully evaluate a few key items as part of your due diligence process.

The DOL Employee Benefits Security Administration offers guidance for evaluating TDFs as a plan fiduciary. Here are some suggestions from a DOL tip sheet:

Glide path—On an annual basis, review glide path performance vs. peers and the degree of tactical asset allocation. You want to determine how this compares with other options in the marketplace. Also evaluate whether a "to" or a "through" glide path best meets participants' withdrawal expectations.

Sub-asset allocation—On an annual basis, review sub-asset allocation performance vs. a broad market-cap-weighted index and the degree of tactical asset allocation. You want to determine how the mix of size and style compares with the index.

Underlying investments—On an annual basis, review the mix of passive vs. active funds offered. For active funds, review the philosophy, process, and performance of the underlying fund managers. For passive funds, review how closely they track their respective benchmarks.

Investment performance—On a quarterly basis, review fund performance vs. both peers and a relevant benchmark. Determine which underlying funds are driving overall performance, and review the fund's rebalancing policy.

Employee communications—On an annual basis, review both the quality and availability of fund communications. You want to determine whether the average employee has access to the information needed to make informed investing decisions.

Parent organization and oversight—Every other year, review the fund's parent organization to determine its oversight structure, experience, and tenure. Also determine if there have been any changes to key personnel within the parent organization.

An outside advisor can analyze these factors and provide a fully independent assessment of your plan's TDFs.