

**Statement before the ERISA Advisory Council
On Employee Welfare and Pension Benefit Plans**

June 11, 2014

**Issue: Outsourcing Employee Benefit Plan Services
Defined Contribution Recordkeeping**

My name is Margaret Raymond, and I serve as Managing Counsel, Retirement and Tax Deferred Investing Group in the Legal Department of T. Rowe Price Associates, Inc. In that role, I have primary responsibility for a team providing legal services to T. Rowe Price Retirement Plan Services, Inc. which provides recordkeeping and administrative services to over 3,493 plans with nearly 2 million participants as of March 31, 2014. A number of those plans are trustee by T. Rowe Price Trust Company, an affiliated, Maryland-chartered trust company. Retirement Plan Services is affiliated with T. Rowe Price Associates, Inc., a registered investment adviser that serves as investment adviser to the T. Rowe Price family of mutual funds. T. Rowe Price offers mutual funds and investment products to defined contribution retirement plans recordkept by Retirement Plan Services as well as those recordkept by other providers.

We appreciate the Council's interest in the complex area of outsourcing for employee benefit plan services. It is an especially important topic for defined contribution (DC) plan sponsors. Outsourcing of DC plan services allows employers to focus on their core business, but increased regulatory and judicial scrutiny of outsourcing practices has created apprehension among DC plan sponsors. Balancing these competing concerns is particularly relevant to the success of a voluntary system that now accounts for much of working Americans' retirement savings. We welcome the opportunity to provide the Council with our insight and perspective.

Background

DC plan recordkeeping in the United States is a complex business. Systems necessary to report daily plan valuation, effectuate participant transactions, perform trades, move money to settle trades, facilitate participant access and generate sponsor reporting are multifaceted. Legal and regulatory developments require frequent, expensive changes to the systems and materials that support recordkeeping. More importantly, recordkeeping is often an important base on which to provide other critical services. Evolving participant and sponsor needs demand new products and services to keep the plan responsive to the sponsor's intended goals. The marketplace is highly competitive and served by a diverse group of financial companies including mutual fund companies, insurance companies, and registered broker-dealers. From the creation of target date funds to lifetime income solutions, these companies are sources of innovation that provide important tools for plans and plan participants to achieve successful outcomes in retirement.

As service providers, recordkeeping entities perform essential and vital functions necessary to maintain a plan in today's marketplace. Their technology enables the production of valuable plan data and information used by sponsors not only to meet their legal and regulatory obligations, but also to evaluate the plan's success in meeting the retirement needs of plan participants. On an individual level, these systems provide the building blocks retirement savers can use to formulate retirement goals and measure progress against them. Recordkeepers serve as the gateway to financial markets by providing access to a wide array of investment options and choices for plan sponsors and participants. They are a source of expert information about the legal, regulatory and industry developments affecting their plan clients. Increasingly, individual participants look to recordkeeping firms to provide basic financial education and planning resources to help them define and meet their retirement savings goals.

DC Recordkeeping Service Configurations

Under the traditional (and largely unchanged) outsourcing model in the DC plan market, service providers are engaged by plan sponsors to provide non-discretionary, directed recordkeeping services. Service agreements typically contemplate that plan sponsors retain authority to manage the plan and its investments (a fiduciary role). Recordkeepers do not make decisions but instead act under a framework of guidelines provided by the fiduciaries with respect to the plan (a non-fiduciary role).

Many recordkeepers have affiliated trust companies that offer limited fiduciary services as directed trustees. In that capacity, these service providers occupy a substantially limited fiduciary role, safeguarding assets and acting on the proper directions of named fiduciaries. In this arrangement, it is the named fiduciary that establishes the plan's investment menu and monitors the menu for any needed changes. This basic model of directed recordkeeper (and directed trustee, when applicable) helps to insure that the service providers performing these valuable functions stay within ERISA parameters when they or their affiliates receive compensation in connection with the investment options included in the plan menu. Some providers, typically insurance companies using group variable annuity contracts with underlying separate accounts, require a named fiduciary to select from a set menu of investment option choices maintained on a platform. Other providers such as T. Rowe Price provide an open platform of investment options by arranging to add funds to their recordkeeping platform as requested. In either case, fiduciary safeguards are met through contracts that require the plan fiduciary—not the recordkeeper or directed trustee—to retain the ultimate authority over the choice of investment options in the menu.

On occasion, plan sponsors retain external parties other than directed trustees to serve in fiduciary capacities. The most traditional version of this—primarily used by large plans—is exemplified by the use of investment managers to oversee one or more specific separate accounts within the plan's investment menu. A trend that developed in the wake of 'stock drop' litigation involved the retention of external independent fiduciaries to exercise discretion over a particular investment option, such as employer stock. An even more recent development is some plan sponsors' use of independent fiduciaries to select and monitor the entire plan line-up. In each of these examples, the party retained is serving as a discretionary investment manager fiduciary under ERISA § 3(38).

Some plan sponsors also retain external providers to assist participants. This can take the form of advisers or consultants who act in a non-fiduciary role to conduct employee meetings targeted to the needs of a particular population. Alternatively, plans can retain third party advice services, such as that provided by Morningstar or Financial Engines. These services allow participants to choose a non-discretionary advice version under which the provider serves as an ERISA § 3(21) fiduciary, or a discretionary advice version under which the provider directs implementation of investment recommendations and serves as an ERISA § 3(38) fiduciary.

Recordkeeper Selection

In a highly competitive and diverse marketplace, the task of choosing among many qualified DC plan service providers—while essential for the plan to operate—can be daunting for plan sponsors. Pricing is an important consideration, but equally important is the question of value. Important components of value include recordkeeping, sponsor reporting capabilities, available investment options, and participant support. Then too, intangible but critical factors include reputation, reliability and fit with sponsor goals. Together with pricing, these factors are central to a sponsor's choice.

Some plan sponsors have the skill and expertise necessary for the prudent selection of a service provider. Increasingly, DC market complexity has caused plan sponsors to turn to advisers and consultants when selecting a recordkeeper. The presence of consultants and advisers in today's market is significant and their unique qualifications assist sponsors who might otherwise lack the necessary experience or resources to identify, evaluate, and select among a large field of providers. The skills and specialized knowledge of these plan advisers and consultants can further the information gathering and analysis in the recordkeeper selection and monitoring process, all keys to prudent fiduciary decision-making by the sponsor.

Advisers and consultants also have a role in continued monitoring of the service provider, especially around pricing. Maintaining the price competitiveness of a plan is in everyone's interest—participants who often bear a portion of the cost, plan fiduciaries who have legal oversight responsibility, and incumbent recordkeepers who seek to preserve valued client relationships. One way to maintain a competitive price and value combination is through an RFP, but it is only one way. Benchmarking exercises without a formal bid process can provide insight on market competitive pricing. Then too, negotiations without formal RFPs can result in re-pricing, as incumbent recordkeepers are keenly interested in retaining their plan clients.

Current Trends

- 1. Pricing trends.** The combined effects of market forces and litigation have enhanced transparency in the DC recordkeeping marketplace. Years before the Department of Labor formalized fee disclosure rules, many recordkeepers began to provide detailed pricing analyses that allowed plan sponsors to understand the connection between indirect compensation (including payments attributable to proprietary or non-proprietary mutual funds) and direct compensation. These detailed cost analyses allowed the industry to develop pricing models that responded to a variety of plan client needs. With these tools, now augmented by ERISA §408(b)(2) disclosures, plan sponsors and their consultants are able to determine the combination of hard dollar fees and share class options that meet their needs. Some sponsors seek to “internalize” fees into investment options while receiving a so-called ERISA budget from which to fund necessary plan expenses. Other sponsors prefer to “externalize” those fees, either paying them directly or having them deducted from plan forfeiture accounts or participant accounts as provided under the terms of the plan. Often plans use a blend of approaches, as it is still common to have participant accounts pay fees for optional services such as loan initiation and/or maintenance.
- 2. Participant Guidance and Education.** Increasingly participants seek to learn about retirement savings in a comprehensive way, and sponsors look to recordkeepers and their affiliates to assist individuals in formulating retirement savings goals, understanding how to maximize their opportunities to achieve those goals while addressing competing priorities. Recordkeepers, with a substantial amount of basic information about individuals' retirement savings, are a natural resource for basic financial education and financial planning services. Plan sponsors whose participants lack financial sophistication seek out providers who can perform this function well. Many of these providers also assist individuals with asset allocation tools and investment guidance that meet the requirements of the Department of Labor's Interpretive Bulletin 96-1.
- 3. Risk Allocation.** Two key areas to mitigate the risk of plan administration are contractual indemnification and fiduciary insurance. (Fiduciary bonding also mitigates risk arising from fraud or dishonesty; as it is required by ERISA, it is not a topic of outsourcing negotiation). Indemnification provisions allocate risk between the plan sponsor and the recordkeeper in the event of negligence, bad faith or willful misconduct. It is common for plan sponsors to retain responsibility for the ordinary “no fault” claims (usually attributable to death and divorce) that surround benefit plans. Increasingly, recordkeepers are exploring liability caps for basic recordkeeping services as the market price for these services continues to drop. Most providers maintain professional liability insurance for their book of recordkeeping business; insurance is not usually specific to a particular plan client.
- 4. Error Correction.** One traditional area of focus in recordkeeper oversight is error correction. From payroll mishaps to processing errors, the complexities and volume of transactions associated with recordkeeping will lead to mistakes on both employer and recordkeeper parts. This fact of a recordkeeping error alone is not the sole determinant of a quality recordkeeper. Rather, the measure of a good service provider is how it responds to problems when they arise. Good service providers act quickly, efficiently, and consultatively with plan sponsors to address mistakes.

5. **Other Contracting Provisions.** Contracting in the DC plan market is competitive and contract provisions reflect this fact. It is common to allow terminations without penalty on relatively short notice. Asymmetric termination provisions, if applicable, largely favor plans. Service level commitments focus on services that the sponsor and provider agree to measure—from response times to various participant requests to participant satisfaction evidenced by survey results. The industry continues to seek measures of participant outcomes that are sufficiently within the control of a recordkeeper to serve as a metric for performance.

Thank you for your attention to the important topic of DC outsourcing practices. We hope that this overview is helpful to your inquiry.

Margaret H. Raymond, Esq.
Managing Counsel, Vice President
T. Rowe Price Associates, Inc.
100 East Pratt Street, BA-1020
Baltimore, MD 21202
(410) 345-5724