

Advisory Council on Employee Welfare and Pension Benefit Plans

Report to the Honorable Thomas E. Perez,
United States Secretary of Labor

Outsourcing Employee Benefit Plan Services

November 2014

NOTICE

This report was produced by the Advisory Council on Employee Welfare and Pension Benefit Plans, usually referred to as the ERISA Advisory Council (the "Council"). The Council was established under Section 512 of ERISA to advise the Secretary of Labor on matters related to Welfare and Pension Benefit Plans. This report examines Outsourcing Employee Benefit Plan Services. The contents of this report do not represent the position of the Department of Labor.

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ABSTRACT

The 2014 ERISA Advisory Council examined the outsourcing of employee benefit plan services with a particular focus on functions that historically have been handled by employers, such as “named fiduciary” responsibilities. The Council also looked at multiple employer plans or “MEPs” and their potential role in the outsourcing industry. Through its examination, the Council’s intent was to identify areas in which the Department could provide education, outreach, regulatory guidance, and sub-regulatory guidance pertaining to employer’s outsourcing of employee benefit plan services. Further, the Council hopes that employers will find its report helpful in understanding outsourcing practices and their underlying legal obligations under the Employee Retirement Income Security Act of 1974.

ACKNOWLEDGEMENTS

The Council recognizes the following individuals and organizations who contributed greatly to the Council's deliberations and final report. Notwithstanding their contributions, any errors in the report rest with the Council alone.

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Outsourcing Employee Benefit Plan Services

I. EXECUTIVE SUMMARY

The 2014 ERISA Advisory Council (the “Council”) examined the role that outsourcing plays in helping plan sponsors and other ERISA plan fiduciaries meet the increasingly complex task of managing and administering their employee benefit plans. Through outsourcing, plan sponsors can gain access to expertise and technology, achieve economies of scale, and reduce costs. Outsourcing also permits a plan sponsor to focus on its core business rather than managing its employee benefit plans. However, most outsourcing arrangements also involve a transfer of responsibility and liability, either by operation of law or by contract, from the plan fiduciary to the outsourced service provider. While this transfer has important consequences both for plan fiduciaries and participants, its implications are not always well defined or understood.

The Council heard witnesses from a variety of constituencies, including plan sponsors, consultants, service providers, academics, liability insurers, and representatives of participant groups. The Council also heard testimony from the Department of Labor (the “Department”). Testimony occurred during two days of public hearings held on June 18, 2014 and August 20, 2014. The record also includes written materials submitted by various witnesses.

The Council formulated several recommendations for the Department grouped into the following five categories: (A) educate plan sponsors on current practices with respect to outsourced services; (B) clarify the legal framework under ERISA for delegating responsibility to service providers; (C) provide additional guidance on the duty to select and monitor service providers; (D) facilitate the use of multiple employer plans and similar arrangements as a means of encouraging plan formation and easing administrative burdens; and (E) update and provide additional guidance on insurance coverage and ERISA bonding of outsourced service providers.

II. RECOMMENDATIONS

The Department should:

- A. Educate plan sponsors on current practices with respect to outsourced services, including:
 - 1. Provide industry information about the range of outsourcing options and types of providers, including with respect to Outsourced Chief Investment Officer (OCIO) arrangements.
 - 2. Provide information on contracting practices such as termination rights, indemnification, liability caps, service level agreements, etc., that might assist plan sponsors and other fiduciaries in negotiating service agreements.
- B. Clarify the legal framework under ERISA for delegating responsibility to service providers in the following respects:
 - 1. The plan sponsor's responsibility under ERISA Section 404 where the plan document designates a "named fiduciary" under ERISA Section 402(a) that is not the plan sponsor.
 - 2. The scope of liability of a fiduciary who appoints a non-fiduciary service provider to perform functions necessary for the operation and administration of the plan.
 - 3. The application of the co-fiduciary provisions of ERISA Section 405 including (i) whether the co-fiduciary liability provisions of ERISA Section 405(c)(2)(B) impose additional obligations on an appointing fiduciary beyond the duty to select and monitor an appointed fiduciary and, if so, the extent of those duties, (ii) the standard of knowledge required for co-fiduciary liability under ERISA Section 405(a), and (iii) contribution rights among co-fiduciaries.
- C. Provide additional guidance on the duty to select and monitor service providers in the following ways:
 - 1. Consolidate prior guidance on a fiduciary's duty to select and monitor service providers.
 - 2. Provide guidance on frequency and scope of monitoring required.
 - 3. Identify "questions to ask" and other best practices in selecting and monitoring service providers.
 - 4. Provide guidance on managing potential conflicts of interest in engaging fiduciary service providers.
 - 5. Publish clear examination and enforcement priorities and follow up with publication of relevant examination findings.

- D. Facilitate the use of multiple employer plans and similar arrangements as a means of encouraging plan formation, including:
 - 1. Consider the benefits of multiple employer plans and similar arrangements in rulings, regulations and interpretations.
 - 2. Consider developing a sample structure for multiple employer plans that will help ensure that conflicts of interest, prohibited transactions, fiduciary independence and disclosure are addressed.
 - 3. Develop rules or safe harbors for multiple employer plan sponsors and adopting employers that would minimize their liability from acts of non-compliant adopting employers.

- E. Update and provide additional guidance on insurance coverage and ERISA bonding of outsourced service providers in the following areas:
 - 1. Clarify and modernize the fidelity bond regulations and Field Assistance Bulletin 2008-04.
 - 2. Educate plan sponsors on availability of fiduciary insurance coverage, including information on scope of coverage, deductibles, policy limits, and ratings of insurers.

III. SUMMARY OF TESTIMONY AND COUNCIL DISCUSSION

This section of the report is organized around the Council’s five categories of recommendations for action by the Department. The section on “Current Practices in Outsourcing” discusses the existing outsourcing marketplace and supports the need for additional education on outsourcing practices to enable more informed decision making by plan fiduciaries. The section on “Legal Framework for Outsourcing under ERISA” outlines the statutory framework established for allocation and delegation of responsibilities under ERISA and discusses specific issues where clarification from the Department would be helpful. The section on “Duty to Select and Monitor Service Providers” reviews existing guidance on how fiduciaries fulfill their obligations when engaging outsourcing service providers and identifies areas where additional guidance would be welcome. The section on “Multiple Employer Plans and Similar Arrangements” examines multiple employer plans as a mechanism to “outsource” the plan sponsor function to a third party. Finally, the section on “Insurance and Bonding Practices” briefly covers the use of commercial insurance coverage as a means of risk allocation or risk mitigation in the context of outsourced services.

The Council wishes to thank all of the witnesses for their insights and perspectives on outsourcing. It should be noted that many witnesses sounded common themes and identified similar issues. Accordingly, this report identifies specific witness testimony only in cases where there was either significant disagreement or the testimony of a witness was particularly relevant. However, whether identified by name or not, the expertise of all of the witnesses contributed immeasurably to this report.

A. Current Practices in Outsourcing

Outsourcing of benefit plan functions, administrative, investment and otherwise, is a practice that predates ERISA. However, its prevalence and scope have grown significantly since ERISA's passage, and has accelerated over the last ten years. Certain functions by their nature must be outsourced to a third party (e.g., auditing a plan's financial statements), while others for practical reasons have been outsourced by most plan sponsors (e.g., defined contribution recordkeeping). In addition, there appears to be an emerging trend toward outsourcing functions that have traditionally been exercised by plan sponsors or other employer fiduciaries (e.g., administrative committee, investment committee, etc.), including functions such as investment fund selection, discretionary plan administration, and investment strategy. There also have been trends towards using multiple employer plan arrangements as a mechanism to "outsource" the provision of retirement plan benefits, particularly in the small company market.

This growth in outsourcing is, in part, a result of ERISA's fiduciary framework which permits assignment of fiduciary functions among different parties. It is also a result of the increasing complexity of employee benefit plan investment and administration which requires specific expertise that in many cases can only be provided by third parties. This section of the report discusses the current market for outsourcing plan services

1. Scope of Services Outsourced.

Virtually any services related to an employee benefit plan can and are being outsourced, and can be outsourced in a variety of combinations. The scope, terms and method of delegating plan services is specified in plan documents, service agreements and other contracts. Types of plan services that are traditionally outsourced include:

Investment Services: Examples include investment strategy, asset allocation, underlying investment management, manager selection and monitoring, and proxy voting.

Administrative Services: Examples include record-keeping, processing claims for benefits, distribution of participant notices and other plan communications, preparation of necessary governmental forms (Form 5500, 1099-R, etc.), contribution processing, execution of investment instructions, and processing plan distributions.

Professional Services: Examples include actuarial, legal, and accounting services.

In recent years, there has also been a trend to outsource functions that have been traditionally performed by the plan sponsor or a person acting on behalf of the plan sponsor.

One particularly notable development is the outsourcing of functions that would usually be performed by a plan sponsor's chief investment officer – known in the industry as an "outsourced chief investment officer" or "OCIO." This is generally described as a single outsourcing services provider assuming responsibility for asset allocation, policy development, investment manager selection, portfolio funding, rebalancing, and ongoing portfolio monitoring. OCIO arrangements are much more prevalent in the defined benefit, rather than the defined

contribution, plan market. However, many witnesses noted that there is increasing interest in OCIO arrangements for defined contribution plans, including participant-directed plans.

The scope of services provided within each OCIO arrangement varies widely and is generally customized to the needs of the plan sponsor. Some plan sponsors may outsource a portion of their portfolio, or outsource only certain of the investment management functions related to the portfolio. However, in virtually all OCIO arrangements, the plan sponsor retains responsibility for the overall strategic goals of the investment process because of the potential financial impact on the plan sponsor. Additionally, the Council learned of the emergence in the marketplace of outsourcing the role of the “plan administrator” as defined in ERISA Section 3(16)(A) and the role of the “named fiduciary” under ERISA Section 402(a).

2. Types of Outsourcing Service Providers.

The types of providers in the marketplace today are largely categorized based on the services being outsourced. In many cases, this is a function of the non-ERISA laws regulating the provision of certain types of services. For example, investment services may require licensing or registration as an investment adviser, broker-dealer, bank or insurance company. Professional services typically require licensing based on the service provided. However, administrative services typically require no special licensing or registration, so are provided by a wide variety of business entities, including financial services firms and professionals, as well as stand-alone administrators (usually referred to as third-party administrators or “TPAs”).

One unique type of outsourcing service provider merits particular mention – a multiple employer plan (“MEP”). A MEP is a single retirement plan that is maintained by a MEP sponsor. An employer can adopt a MEP as a way of outsourcing virtually all functions associated with sponsoring and maintaining a retirement plan. These arrangements present unique challenges and opportunities and are discussed below in the section on “Multiple Employer Plans and Similar Arrangements.”

3. Reasons for Outsourcing.

For many sponsors, the tasks associated with maintaining an employee benefit plan, including administration and recordkeeping, investments, legal and compliance requirements, reporting and disclosure, and participant communications have become unmanageably complex. Plan sponsors turn to outsourcing so that they may devote more time and energy to their primary responsibility of running their business.

In addition to allowing plan sponsors to focus on their core business, the most frequently cited benefits of outsourcing include:

Cost and economies of scale. An outsourcing service provider may cost less than performing the services in-house based on economies of scale and other factors.

Access to technology. Outsourcing gives plan sponsors access to the most cutting-edge technologies needed to support complex plan transactions, including recordkeeping, plan

valuation, investment transactions, participant and plan sponsor reporting, and Internet access.

Access to legal and compliance expertise. The legal requirements of administering ERISA-covered plans and managing plan assets have grown increasingly complex while the consequences of failing to meet these requirements have become more onerous.

Limiting plan sponsor fiduciary risk. Fiduciary risk may be further limited to the extent that the third party provides improved plan administration, management and compliance processes.

While limiting fiduciary risk is often cited by plan sponsors as a reason for outsourcing, the Council heard testimony from a number of witnesses who emphasized that outsourcing cannot relieve the plan sponsor of all fiduciary obligations. These same witnesses also pointed out that many plan sponsors may not be aware of the scope of the liability that they retain. With some providers promising “fiduciary protection services” or stating that they are willing to assume “co-fiduciary liability,” there appears to be considerable confusion in the market over the precise extent to which plan sponsors have limited fiduciary risk through outsourcing arrangements. Combined with the lack of clear guidance on certain aspects of the legal framework for outsourcing discussed in section B below, the marketplace could benefit from additional guidance from the Department in this area.

4. Contracting Practices.

The service provider contract is at the heart of all outsourcing arrangements. It is much more than just a legal document for allocating risk among the parties. The contract presents an opportunity to create a roadmap for the complex and customized relationships often involved in employee benefits outsourcing.

The written testimony of Brian Golub, Global General Counsel & Chief Compliance Officer for Russell Investments, included a useful framework for the focus of the contracting effort:

Defining the assignment. To be an effective “roadmap” for the relationship, a contract must lay out exactly what elements of the program are outsourced, which fiduciary functions are delegated to the provider and which are retained by the sponsor, and what other services may be provided. This is critical, both legally and practically. Effective delegation under ERISA requires explicit transfer and acceptance of fiduciary duty, and setting clear expectations for roles and responsibilities is essential as the basis for *accountability*.

In my experience too much of the outsourcing discussion focuses on whether or not the provider is “a fiduciary” and not enough on who is actually doing what. Outsourcing assignments usually include a combination of discretionary management and expert advice, along with other services or information that may or may not fit the ERISA definition of “fiduciary.”

The plain language of ERISA allows the parties to define (and limit) the scope of the fiduciary role delegated. But in practice the fiduciary label carries very specific expectations

and can act as a kind of straight jacket, limiting the parties' ability to design the program as they see fit. In other areas (where the delegation of fiduciary status is less obviously involved), providers may either refuse fiduciary status or turn down the assignment, for fear that fiduciary status may make it impossible for them to avoid liability for areas beyond their control or sphere of influence. In some cases, providers may even choose to withhold information or services that might otherwise be valuable, for fear that, *if* they provide the information or service, they will be held to a fiduciary standard or be treated as engaging in a prohibited transaction. That has more to do with providers and sponsors protecting themselves than promoting participant retirement income security. Taking a different approach, I have found that it is more effective if the parties start with defining their actual roles first, and then deciding which of them should carry the "fiduciary" label.

Providing a clear standard of care. Most clients have a high expectation that we will "stand behind" our work. But, as above, many conversations about responsibility also become confused with fiduciary status. Again, I have found that it is more productive to separate discussions of the standard of care from fiduciary status itself. For functions that are fiduciary by definition, the standard of care is set. But that does *not* mean that the provider must agree to fiduciary status to agree to the standard of care. Often there are sound reasons that *both* parties might not want to delegate the fiduciary duty (or status) for a particular function, even though the provider has valuable expertise to offer, and both parties agree that the program would be better off if that expertise were part of the process.

We generally apply a uniform standard of care (the ERISA prudent expert standard) for the services provided under a contract, wherever we are offering the service as an expert, whether or not we technically are a "fiduciary" under ERISA. Further to this purpose, we prefer simpler liability and indemnification provisions that do not indirectly modify the agreed standard. We also are clear where we are providing additional "non-expert" information or assistance and in some cases clarify that we are not offering it independently or expertly. Generally, we do not disclaim the prudent expert standard for these additional services, as both the standard itself and the context usually provide us comfort that we are not accepting unreasonable liability. But we believe it is appropriate to offer the industry (including us) the option to disclaim the higher standard of care for non-expert services.

Transparency of consideration. Alignment in an outsourcing relationship requires full, and *understandable*, disclosure of how (and how much) the outsourcer will get paid. Some of the worst examples of abuse are found in compensation that is either not disclosed or obscured in contract language that is simply not "understandable." In simple, AUM-fee based arrangements, contracts can address this fairly simply, by including full compensation on a simple fee schedule and representing that there is no undisclosed compensation. These provisions can be more challenging as outsourcing models become more complex. Even so, with plain English, simplicity and effective engagement by the sponsor (consistent with *its* fiduciary duty), I have found that transparency is not usually a technical challenge.

Similarly, witnesses commented that a contract should be clear and transparent with respect to terms of payment. One model for payment to OCIO's is an all-inclusive fee which covers all functions outsourced, including the fees of underlying investment managers. The client pays a single amount to the OCIO, and the OCIO negotiates with underlying managers. Under other models, the plan sponsor pays the OCIO a fee for its functions, and separately pays a fully

transparent fee to each underlying manager. The formula and level of the fee may be a flat, hard dollar fee, or based on the market value of the portfolio it manages. Witnesses also commented on the need to avoid conflicts of interest and ensure transparency in the case where OCIO's have affiliates engaged in asset management, retail financial advice, investment banking and/or broker-dealer activities.

Current trends point to increasing use of outsourcing for a wide range of administrative and investment decisions and services. Many witnesses cautioned that, under these circumstances in particular, fiduciary responsibilities need to be clearly delineated, and additional guidelines for selecting and monitoring service providers would be helpful. Also, plan sponsors often are unclear about exactly what services are being offered. Some combination of education and best practice standards would help plan sponsors and providers achieve the goals set forth above for the contracting process.

B. Legal Framework for Outsourcing under ERISA

The Council received a considerable amount of oral and written testimony regarding the ERISA legal framework of the outsourcing process. Multiple witnesses stated that many plan fiduciaries look to outsourcing arrangements in order to limit their exposure to fiduciary liability under ERISA. Further, witnesses testified that many plan sponsors and plan fiduciaries do not understand this framework or the extent to which they remain subject to ERISA when outsourcing plan responsibilities. From this testimony, the Council identified legal issues that should be considered by fiduciaries when considering opportunities to outsource plan responsibilities and maintaining the outsourcing relationship. These issues include the following: (1) named fiduciaries, trustees, and the allocation or delegation of fiduciary responsibilities; (2) the extent of co-fiduciary liability; (3) the difference between fiduciary and ministerial functions; (4) the “delegation” of non-fiduciary functions; and (5) where fiduciary liability under ERISA ultimately lies when a fiduciary allocates or delegates fiduciary responsibility.

1. Named Fiduciaries, Trustees and the Allocation or Delegation of Fiduciary Responsibilities

ERISA Section 402(a) provides that every employee benefit plan must through the governing plan documents provide for one or more “named fiduciaries.” The named fiduciaries have the authority to control and manage the operation and administration of the plan. A “named fiduciary” is either (i) named in the plan documents or (ii) named by either an employer or employee organization (or both an employer and employee organization acting jointly) pursuant to a procedure set forth in the plan documents. Named fiduciaries may control and manage the operation or administration of the plan as a group (i.e., jointly) or the responsibilities to control and manage the plan can be allocated among named fiduciaries. If the responsibility to control and manage is allocated among named fiduciaries, ERISA Section 402(b) requires that the plan documents include a procedure pursuant to which such allocation will occur.

Named Fiduciary Allocation or Delegation of Non-Trustee Responsibilities

ERISA Section 405(c) further addresses the allocation of fiduciary responsibilities that are not trustee responsibilities. It provides that the plan documents may include procedures (i) for allocating fiduciary responsibilities (other than trustee responsibilities) among named fiduciaries, and (ii) for named fiduciaries to designate persons other than named fiduciaries to carry out fiduciary responsibilities (other than trustee responsibilities) under the plan. If the plan expressly provides for a procedure to allocate fiduciary responsibilities among named fiduciaries, or to delegate fiduciary responsibilities and such allocation or delegation occurs, a named fiduciary will not be responsible for the actions of the other named fiduciaries. However, the named fiduciary will be liable for the actions of another named fiduciary to the extent the named fiduciary:

- (i) fails to comply with ERISA's co-fiduciary liability provisions, which are explained in more detail below in section IV.B.5 of this report, or
- (ii) fails to comply with its fiduciary duties (a) with respect to such allocation or delegation, (b) with respect to the establishment or implementation of the allocation or delegation procedure, or (c) in continuing the allocation or delegation.

In other words, the named fiduciary must be prudent and act in the best interests of the plan when it makes the decision to delegate to another fiduciary (e.g., the delegate is appropriately qualified to perform the functions delegated to it) and when it makes the decision to continue to delegate to that fiduciary on an ongoing basis (e.g., the delegate continues to be appropriately qualified to perform the functions delegated to it). Thus, the delegating fiduciary has a duty to monitor the performance of the fiduciary to whom fiduciary responsibilities are delegated. Moreover, the fiduciary must comply with ERISA's co-fiduciary liability provisions. As Colleen E. Medill, a professor of law at the University of Nebraska College of Law, testified and as discussed in section IV.B.5 below, neither the Department nor the courts have provided any guidance regarding how a named fiduciary may comply with both the co-fiduciary liability provisions and the aforementioned duty to monitor. The Council believes that the Department should issue guidance to clarify how these two ERISA provisions are to be applied.

Named Fiduciary Allocation or Delegation of Trustee Responsibilities

ERISA Section 403, unlike ERISA Section 405(c), applies to trustee responsibilities. It provides that, except under limited circumstances, a plan's assets are to be held in trust by one or more trustees. Such trustee or trustees must be named in the trust agreement or the plan documents, or must be appointed by a named fiduciary as described above. Further, the trustee must accept its appointment as trustee.

A trustee has the exclusive authority and discretion to manage and control the assets of the plan, except to the extent that (i) the plan documents expressly provide that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee or (ii) the named fiduciary has delegated authority to manage, acquire, or dispose of assets of the plan to one or more

investment managers pursuant to ERISA Section 402. In the latter case, ERISA Section 402(c)(3) provides that a plan may provide that a named fiduciary may appoint an investment manager or managers, rather than a trustee, to manage (including the power to acquire and dispose of) any assets of a plan. The term “investment manager” is defined in ERISA Section 3(38). In the event of any appointment under 402(c)(3), the named fiduciary is not liable for the acts or omissions of the investment manager so long as it was prudent in selecting and retaining the investment manager. Also, the co-fiduciary provisions apply when investment authority is delegated to the investment, but more narrowly than in other circumstances.

In the case of a trustee who is directed by a named fiduciary (commonly referred to as a “directed trustee”), the trustee will not be liable for breaches of fiduciary duty when acting upon such direction unless to do so would be contrary to the terms of the plan document or in violation of the fiduciary duty provisions of ERISA. ERISA Section 405(b) provides that co-trustees (i) must use reasonable care to prevent a co-trustee from committing a fiduciary breach and (ii) must jointly manage and control the assets of the plan. However, the trust agreement may authorize an agreement allocating specific responsibilities, obligations, or duties among trustees. In the latter case, a trustee is not liable for any losses caused by another trustee’s acts or omissions.

Plan Sponsor Designation of Named Fiduciary in Plan Document

The above discussion addresses the situation under which the plan provides for a procedure under which a named fiduciary is selected under a procedure in the plan. In that context, the person responsible for selecting the named fiduciary has a fiduciary responsibility for appropriately selecting and monitoring the named fiduciary. However, ERISA Section 402(a) also provides that the named fiduciary may be named in the plan document. As such, ERISA may be interpreted to provide that the designation of the named fiduciary in the plan document is a settlor act. Thus, the naming and retention of the named fiduciary would not be subject to ERISA’s fiduciary duty provisions.

Professor Medill confirmed this interpretation in her testimony before the Council. She noted that ERISA does not require that the employer act as the named fiduciary and that this responsibility could be outsourced. Further, pursuant to the “non-fiduciary settlor doctrine,” the plan sponsor would be acting as a non-fiduciary in this capacity. Thus, it would not be subject to ERISA in drafting the plan to include one or more named fiduciaries. Therefore, among other things, there would be no duty to monitor on the part of the sponsor. On the other hand, Lou Campagna of the Department’s Employee Benefit Security Administration (“EBSA”) testified that he did not believe that the Department has ever addressed this particular question, but provided his personal view that the designation of the named fiduciary in the plan document may itself be a fiduciary act. Further, he noted that the selection of a plan service provider as the named fiduciary by the employer would be a fiduciary act because the employer would be exercising control with regard to plan management and the designation of the plan service provider in the plan document would not change that. The Council believes that guidance from the Department on this critical foundational issue would be very helpful to plan fiduciaries as they consider a variety of outsourcing arrangements.

2. Co-fiduciary Liability under ERISA Section 405

As described above, a named fiduciary or trustee can allocate or delegate fiduciary responsibilities and thereby limit its exposure for acts that are properly delegated to another fiduciary liability. However, the named fiduciary and the trustee continue to be subject to the co-fiduciary liability provisions under ERISA Section 405(a). Thus, the named fiduciary is liable for a breach of fiduciary responsibility of another fiduciary under the following circumstances: (i) if he or she knowingly participates in an act or omission or knowingly undertakes to conceal the act or omission of another fiduciary when he or she knows the act or omission is a breach of fiduciary duty, (ii) if the fiduciary, by failing to comply with ERISA's general fiduciary duty provisions, enables the other fiduciary to commit a breach; or (iii) if he or she has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach. The only exception occurs when the named fiduciary delegates investment authority to an investment manager. In that case, the named fiduciary is only liable as a co-fiduciary if he knowingly participates in a breach. Professor Medill testified that the co-fiduciary liability provisions will become more important as the outsourcing trend continues and she noted several areas in which the Department could provide guidance regarding how ERISA Section 405 applies.

The co-fiduciary provisions of ERISA in part provide that a fiduciary is jointly and severally liable for the actions of another fiduciary if the fiduciary knowingly participates in the breach or learns of the breach but does nothing to remedy it. Professor Medill noted that some courts have held that the fiduciary must have "actual knowledge" in order to knowingly participate in a breach, but the case law is sparse and the Department has not issued related interpretive guidance. In addition, the courts are split regarding whether the fiduciary must have "actual knowledge" or "constructive knowledge" (i.e., should have known) of the other fiduciary's breach, thus requiring him to make reasonable efforts under the circumstances to remedy the breach. She suggested that it would be helpful if the Department clarified what "knowledge" standard applies under both provisions.

In addition, a fiduciary's joint and several liability resulting from another fiduciary's breach that was caused by the first fiduciary's breach of fiduciary duty may be significant in the outsourcing context and more clarity around the application of this provision is necessary. A named fiduciary that allocates or delegates its fiduciary responsibility to another fiduciary has a duty to monitor that fiduciary. However, a question arises whether this co-fiduciary liability provision imposes additional requirements on the delegating fiduciary. Professor Medill suggested that the Department issue guidance regarding the interaction of these provisions.

Finally, Professor Medill pointed out that the courts have not provided much guidance on whether one fiduciary has the right to sue another fiduciary for equitable relief under ERISA. She noted that this issue will be of increased importance as more employers and other named fiduciaries look to outsource fiduciary functions. Likely, in a co-fiduciary situation, one fiduciary is more culpable than the other. Thus, while both fiduciaries are jointly and severally liable under ERISA, the less culpable fiduciary may wish to sue the other fiduciary for damages in a contribution or similar action. State laws providing for contribution rights may be preempted, so fiduciaries need assurances that such a remedy is available under ERISA.

Professor Medill also emphasized that the agreements among the plan fiduciaries should be well drafted to contemplate appropriate remedies in these situations (assuming ERISA otherwise permits them).

3. Fiduciary vs. Ministerial Functions

The Council also heard testimony that the providers to whom plan services are outsourced act as fiduciaries in some situations but not in others because they merely perform ministerial functions. At times, the line between fiduciary versus non-fiduciary status in outsourcing arrangements may become blurred. As such, it is important for both the named fiduciary and the provider to understand their roles and their responsibilities under ERISA.

As discussed above, a person may be a fiduciary by reason of being a named fiduciary or trustee. Also, ERISA Section 3(21) provides for a functional definition of fiduciary. Thus, a person is a fiduciary to the extent that he or she (i) exercises any discretionary authority or discretionary control respecting management of the plan, (ii) exercises any authority or control respecting management or disposition of the plan's assets, (iii) renders investment advice with respect to plan assets for a fee or other compensation, or has any authority or responsibility to do so; or (iv) has any discretionary authority or discretionary responsibility in the administration of the plan. However, the Department in its Interpretive Bulletin 75-8 states that a persons who performs purely ministerial functions within a framework of policies, procedures and rules developed by others are not fiduciaries. The rationale for this conclusion is that the person lacks the requisite authority, discretion or control to make him or her a fiduciary. For example, the application of eligibility rules, calculation of service credits, preparation of employee communications materials, calculation of benefits, collection of contributions, processing of reports and processing of claims are non-fiduciary acts, so long as those acts are performed within a framework or procedure established by a named fiduciary.

A named fiduciary that enters into an outsourcing arrangement should understand the difference between the two categories of service providers. In addition, all parties to the arrangement should have a clear understanding of each other's roles. As noted by both Skip Halpern of Gallagher Fiduciary Advisors and Brian Golub of Russell Investments, an understanding of all parties of this distinction is important. Both also stated that the agreements governing the outsourcing arrangement were a good place to help make the parties roles' clear. Of course, as noted by several witnesses, ERISA provides for the above functional test of fiduciary status so that a statement in a contract that an outsourcing services provider is not a fiduciary does not necessarily mean that the provider is in fact not a fiduciary and that the facts and circumstances of the situation will ultimately determine fiduciary status.

4. Delegation of Non-fiduciary Functions

As discussed earlier in this report, plan fiduciaries can and often do hire service providers (both fiduciary and non-fiduciary) to help them perform many of the functions needed to manage a plan. In fact, ERISA permits fiduciaries to engage third parties to assist the fiduciary in performing their fiduciary functions with regard to the plan. Specifically, ERISA Section 402(b)(2) allows a named fiduciary, or a fiduciary designated by a named fiduciary pursuant to a

procedure in the plan documents, to employ one or more persons to render advice with regard to any responsibility such fiduciary has under the plan. In the event that a named fiduciary employs such a person to provide such advice, nothing in ERISA states that the named fiduciary is not liable under ERISA if it acts upon the advice of such person and its actions result in a breach of fiduciary duty. This is the case whether or not the advice provider is a fiduciary for purposes of ERISA.

In other words, in the absence of an appointment or delegation by a named fiduciary in accordance with ERISA Sections 402, 403, and/or 405, the employment of a person by the named fiduciary to provide non-fiduciary or fiduciary services is not treated the same as a designation of a fiduciary by the named fiduciary to carry out fiduciary responsibilities under ERISA Section 405(c). Therefore, if a named fiduciary hires a third party to perform non-fiduciary plan services or to perform fiduciary services without an allocation or delegation as described in section IV.B.1, he or she will not be able to claim under ERISA Section 405(c) that he or she is not liable for the actions of the third party service provider. In effect, the fiduciary cannot delegate fiduciary liability when it hires a non-fiduciary service provider in these circumstances.

On the other hand, ERISA only requires that a fiduciary perform its duties in accordance with its fiduciary duties under ERISA. Thus, if the named fiduciary is prudent in its hiring and retention of the service provider, ERISA may be interpreted to provide that the fiduciary is not liable to the plan for any losses that is incurred by reason of the service provider's actions. If the service provider is a fiduciary, the participant can bring a cause of action against the fiduciary under ERISA. However, if the provider is not a fiduciary, the participant will likely not have a cause of action under ERISA against the service provider. Norman Stein, testifying on behalf of the Pension Rights Center, expressed concern that participants lacked a remedy under ERISA in these circumstances because the fiduciary did not breach its fiduciary duty and the service provider was a non-fiduciary and thus could not be held liable under ERISA. Mr. Campagna of the EBSA confirmed this possible outcome, but he also testified that, even if the fiduciary was not liable for the service provider's actions, the fiduciary may have a duty under ERISA to pursue a claim against the service provider on behalf of the plan. Thus, a participant may in fact be made whole by the actions of the fiduciary against the non-fiduciary provider.

5. Fiduciary Liability upon Allocation or Delegation of Fiduciary Responsibility - The Buck Stops Where?

Based upon the oral and written testimony from a number of witnesses, the Council learned that the provisions under ERISA that govern outsourcing arrangements are (i) complex, (ii) not widely understood by plan sponsors and other fiduciaries, and (iii) not clear in several key respects. Thus, plan fiduciaries face challenges in determining who is ultimately liable for what or, in other words, where "the buck stops." However, the Council believes that the Department can play a key role in better defining the roles and responsibilities of plan sponsors, named fiduciaries, and service providers to whom key plan responsibilities are outsourced. This can be accomplished by (i) clarifying whether, by naming the named fiduciary in the plan document, the "buck" essentially stops at the named fiduciary rather than the employer, (ii) defining the scope of fiduciary liability when a the fiduciary outsources plan services to non-fiduciary services

providers, and (iii) explaining how the co-fiduciary provisions interact with the general fiduciary duty provisions in the outsourcing context and the knowledge requirement.

C. Duty to Select and Monitor Service Providers

A fiduciary's primary function in outsourcing activities to a third-party is the selection and monitoring of the service provider. As described in section B above, in the case of delegation of a function that is fiduciary in nature, recourse against the delegating fiduciary may be limited to a violation of the duty to select and monitor. However, despite the importance of the concept of selection and monitoring of service providers, the Council heard a great deal of testimony suggesting that plan sponsors and other fiduciaries need additional guidance on how to meet those duties. This section of the report examines several aspects of the duty to select and monitor that support the Council's recommendation that the Department provide further guidance in this area.

1. Existing Department Guidance on Duty to Select and Monitor

The basic legal framework for imposing a duty to select and monitor service providers derives from ERISA's fiduciary responsibility rules. As explained by Mr. Campagna of EBSA:

Basically, the selection of service providers for a plan, including fiduciaries, is an exercise of discretionary authority or control over the management and administration of a plan within the meaning of Section 3(21) of ERISA and therefore is a fiduciary act subject to the general fiduciary standards. Similarly, decisions to retain and remove service providers are also fiduciary acts subject to these standards. The selection and monitoring of service providers is subject to the prudence and loyalty requirements of 404, and also the prohibited transaction provisions of 406 govern the selection of service providers.

The Department has addressed the application of these fiduciary principles to the selection and monitoring of service providers both generally and with respect to certain types of service providers.

Early guidance on the duty of ongoing monitoring of delegated fiduciary functions is contained in IB 75-8, FR-17, which provides:

At reasonable intervals the performance of trustees and other fiduciaries should be reviewed by the appointing fiduciary in such manner as may be reasonably expected to ensure that their performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan. No single procedure will be appropriate in all cases; the procedure adopted may vary in accordance with the nature of the plan and other facts and circumstances relevant to the choice of the procedure.

This "facts and circumstances" nature of the duty is a theme reiterated throughout subsequent Department guidance.

In an information letter issued to Theodore Konshak (December 1, 1997), the Department stated that the selection of an actuary is a fiduciary function and elaborated on the factors that should be considered by a fiduciary in selecting a service provider: "... the qualifications of the service provider, the quality of the work product, and the reasonableness of the fees charged in light of the services provided." The Department went on to suggest that soliciting bids among service providers is a means by which the fiduciary can obtain the necessary information but stopped short of mandating a bidding process as a necessary feature of the selection process.

These principles were reiterated in an information letter to Diana Ceresi (February 19, 1998), which identified several additional factors that fiduciaries should consider, including ease of access to the information offered by the provider, the timely consideration or resolution of complaints and independent rating or accreditations. The Department also specifically addressed the question of consideration of quality of services in relation to cost and stated:

[T]he fiduciary need not select the lowest bidder when soliciting bids, although the fiduciary must ensure that the compensation paid to a service provider is reasonable in light of the services provided to the plan. It also should be noted that, because "quality of services" is a factor relevant to selection of a service provider, it is the view of the Department that a plan fiduciary's failure to take quality of services into account in the selection process would constitute a breach of the fiduciary's duty under ERISA...

Similarly, Advisory Opinion 2002-08A (August 20, 2002) outlined the same principles in connection with the selection of an actuarial services provider. The Department also specifically addressed the question of whether a fiduciary could hire a provider where the contractual arrangement included a limitation of liability and an indemnification provision in favor of the service provider. In ruling that agreeing to such provisions is not per se imprudent, the Department stated that a fiduciary should "assess the plan's ability to obtain comparable services at comparable costs either from service providers without having to agree to such provisions, or from service providers who have provisions that provide greater protection to the plan."

Finally, Field Assistance Bulletin 2007-01 addressed the application of ERISA standards to the selection and monitoring of investment advisors for participants and beneficiaries in a participant-directed individual account plan. The Department provided additional factors to be considered by fiduciaries: "the experience and qualifications of the investment adviser, including the adviser's registration in accordance with applicable federal and/or state securities law, the willingness of the adviser to assume fiduciary status and responsibility under ERISA with respect to the advice provided to participants, and the extent to which advice to be furnished to participants and beneficiaries will be based upon generally accepted investment theories."

Field Assistance Bulletin 2007-01 also addressed the monitoring obligation in some detail in the context of investment advisers by stating:

In monitoring investment advisers, we anticipate that fiduciaries will periodically review, among other things, the extent to which there have been any changes in the information that served as the basis for the initial selection of the investment adviser, including whether the adviser continues to meet applicable federal and state securities law requirements, and whether the advice being furnished to participants and beneficiaries

was based upon generally accepted investment theories. Fiduciaries also should take into account whether the investment advice provider is complying with the contractual provisions of the engagement; utilization of the investment advice services by the participants in relation to the cost of the services to the plan; and participant comments and complaints about the quality of the furnished advice. With regard to comments and complaints, we note that to the extent that a complaint or complaints raise questions concerning the quality of advice being provided to participants, a fiduciary may have to review the specific advice at issue with the investment adviser.

The Department has also provided informal guidance through several different publications. These include:

Tips for the Selection and Monitoring of Service Providers for Your Employee Benefit Plan. The tips include suggestions such as:

- an employer consider what types of services are needed for the plan;
- provides questions to ask prospective service providers;
- stresses the importance of contracting arrangements;
- advises employers to keep records of the selection process; and
- periodically review performance of service providers.

The tips also discuss costs and notes that cost is only one factor to be considered in service provider selection.

Meeting your Fiduciary Responsibilities. This publication is a simplified explanation of the basic fiduciary responsibilities applicable to retirement plans under the law. It includes information about delegating functions to a service provider and notes that the plan sponsor is required to monitor the third party periodically to ensure that it is handling the plan's investments prudently and in accordance with the appointment. It also includes tips for selecting and monitoring a service provider.

Selecting and Monitoring Pension Consultants – Tips for Plan Fiduciaries. This is a fact sheet that the Department developed in conjunction with the Securities and Exchange Commission, which includes a set of questions to assist plan fiduciaries in evaluating pension consultants and other professionals. Questions include whether the pension consultant has a relationship with a money manager that is being recommended, whether the pension consultant receives any payments from the money managers that are recommended, and whether the pension consultant has policies and procedures in place to prevent these payments or relationships from being a factor where the consultant provides recommendations to the clients.

These publications were cited by many witnesses as the type of practical guidance for plan fiduciaries that the Department can provide. Several witnesses commented that the questions included in *Selecting and Monitoring Pension Consultants – Tips for Plan Fiduciaries* are included in virtually every Request for Proposal issued in connection with investment consulting services and have almost become an industry standard.

Taken together, this informal guidance suggests protocols for selecting and monitoring service providers. However, because this guidance has been provided over many years and in specific contexts, it is difficult for plan sponsors to find and apply it to different outsourcing situations. Many witnesses testified that some modest edits to the plain language guides, particularly in the area of fiduciary services, would be helpful to plan sponsors.

2. Qualifications of Service Providers

ERISA imposes no minimum standards on the qualification of service providers who provide outsourcing services to employee benefit plans. And while service providers performing fiduciary services for plans are subject to ERISA's fiduciary conduct standards and prohibited transaction rules, non-fiduciary service providers are not subject to any explicit conduct standards under ERISA. This could be viewed as consistent with ERISA's provisions that impose full responsibility for plan administration on the plan's named fiduciary or named fiduciaries because there are no minimum qualifications to serve as a named fiduciary of an employee benefit plan.

Several witnesses raised the question of whether the Department should develop minimum standards for service providers. Almost uniformly, the witnesses stated that this proposal was a bad idea. Absent statutory authority, several questioned the ability of the Department to adopt such qualification requirements and virtually all believed that these requirements would constrain flexibility and inhibit innovation in the marketplace. Accordingly, the Council is not making any recommendations in the area of developing minimum standards for service providers.

Nevertheless, in fulfilling the duty to select and monitor, assessing the qualifications of the service provider is perhaps one of the most important factors that a fiduciary must take into account. Factors that should be considered include: (1) financial soundness; (2) expertise; (3) training; (4) business model; (5) registration and licensing, where applicable; and (6) reputation. The relative importance of these factors varies based on both the type of service being outsourced and the type of provider used.

3. Reliance on Consultants and Other Experts

Where plan sponsors and plan fiduciaries do not have the expertise needed to evaluate service providers, they may engage consultants and other experts to assist with the task of selecting and monitoring service providers. The presence of consultants 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 consultants can further the information gathering and analysis in the selection and monitoring process and can be a component of demonstrating due diligence in the exercise of the duty to select and monitor. However, witnesses generally maintained that reliance on a consultant would not, in and of itself, relieve a fiduciary from liability for breach of the duty to select and monitor.

Advisers and consultants also have a role in continued monitoring of service providers, especially around pricing. Maintaining 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. Benchmarking exercises without a formal bid process can also provide insight on market competitive pricing.

Witnesses who addressed OCIO's generally felt that selection and monitoring in this area is considerably more complex than most outsourcing arrangements. Because an OCIO provider has multiple tasks, each of the functional areas needs to be evaluated independently.

4. Benchmarking and Performance Measurement

A key component of selection is assessing the relative qualifications of different service providers. Benchmarking of performance can play a key role in assessing these qualifications. However, most witnesses stated that in areas other than investment management, benchmarking standards are not well-developed for most outsourced services. Similarly, a key component of monitoring service providers is ongoing performance measurement. As with benchmarking, many witnesses testified that there are few standards for measuring performance and that the industry might benefit from a more coordinated approach.

D. Multiple Employer Plans and Similar Arrangements

The Council heard a considerable amount of testimony about the use of multiple employer plans ("MEPs") and similar arrangements where virtually all aspects of plan governance and administration are handled by someone other than the employer who wishes to provide retirement benefits to its employees. In these arrangements, the employer's role is usually limited to the decision to adopt the plan and enter into an agreement to make whatever contributions may be required under the plan and to provide certain data (e.g., date of birth, date of hire, etc.) necessary to operate the plan. In a sense, these plans are the ultimate form of outsourcing since all functions can be outsourced other than those that must, by necessity, be performed by the plan sponsor.

1. Benefits of Full Outsourcing Through MEPs

A MEP is a single "plan" for purposes of ERISA in which two or more unaffiliated employers participate. The participating employers adopt or otherwise agree to participate in the plan. Pursuant to the agreement, the employer will provide participant level information (e.g., payroll data) and send participant and employer contributions to the trustee. The "named fiduciary" with respect to the MEP is defined in the plan document and is often the sponsor of the MEP or a person designated by the MEP sponsor. The "sponsor" of the MEP varies by the type of MEP. In one kind of MEP, the sponsor is a group or association of employers, acting on behalf of its employer members, that establishes the plan. In another kind of MEP, commonly referred to as an "open MEP," the sponsor is an entity that forms the plan strictly for the purpose of providing the plan to the participating employers. The MEP is "open" because the participating employers do not need to be members of a group or association of employers in order to participate. The participating employers will sometimes agree to be co-sponsors of the MEP with the lead sponsor. Employees of the lead sponsor may be eligible to participate in the MEP.

Where a MEP is treated as a single plan for purposes of ERISA, there are certain advantages to the participating employers. Most of the functions (both settlor and fiduciary in nature) are carried out by the group, association or lead sponsor. Thus, they are responsible for plan amendments, plan terminations, and similar functions. In addition, the sponsor or a party or parties designated by the sponsor acts as the named fiduciary or fiduciaries to the plan. The named fiduciary is then responsible for plan administration (e.g., benefits determinations), plan investments (e.g., selecting a lineup of mutual funds, variable annuities, or other options in which participants may invest in the case of a self-directed defined contribution plan), and selection of service providers. A single IRS Form 5500 is filed on behalf of the plan and the plan is subject to a single audit by a certified public accountant (assuming that the plan has more than one hundred participants and therefore is subject to the audit requirement). The role of the participating employers is limited to determining whether or not to become a participating employer and to provide data and contributions to the named fiduciary and plan trustee. Effectively, the participating employer has outsourced the provision of retirement benefits.

Several witnesses maintained that MEPs were advantageous to small employers and encouraged their use, particularly if certain legal clarifications are provided by the Department as discussed below in section IV.D.3. Aliya Wong of the U.S. Chamber of Commerce testified that one way to increase retirement plan sponsorship among small businesses that do not currently sponsor plans would be to facilitate and expand the use of MEPs. She stated that MEPs may offer an attractive and cost-efficient alternative for small businesses where a stand-alone plan is not feasible. She noted that the MEP is a very good vehicle for centralizing plan functions, which can translate to substantial economies of scale and cost efficiencies over stand-alone plans for small businesses. Further, the Council learned that lack of retirement plan coverage is a significant issue. Troy Tisue of TAG Resources stated that 72% of businesses with 500 employees or less, which the Small Business Administration defines as a small business, do not offer plans to their employers. Professor Stein, testifying on behalf of the Pension Rights Center, noted that, if they are run properly, MEPs have the potential to increase plan sponsorship, lower fees paid by participants, and result in better services with less conflicts.

2. Barriers to the Use of MEPs

Mr. Powers, Mr. Tisue, and Bob Toth, legal counsel to TAG Resources, who are involved in the MEP industry, testified that the Department's Advisory Opinion 2012-04A prohibits the use of open MEPs in the manner described above to the disadvantage of small businesses and their employees. In Advisory Opinion 2012-04A, the Department restated the position it has taken in advisory opinions relating to multiple employer welfare arrangements ("MEWAs"). In order to have a single multiple employer plan, there must be an "employment based common nexus or other genuine organizational relationship that is unrelated to the provision of benefits" between the lead sponsor of "the employers of employees that benefit from the Plan, or among the different groups of employees that participate in the Plan."

Applying the nexus requirement in this manner means that any arrangement intended to be organized as an "open MEP" cannot be treated as a single plan but is instead an aggregation of many single plans, each with its own plan sponsor. The lead sponsor and the named fiduciaries

are either non-fiduciary or fiduciary service providers. Under this structure, to at least some extent, the economies of scale offered by the MEP are lost. Each plan must file its own IRS Form 5500 and, if the plan has more than 100 participants, it must retain an auditor to conduct its own audit. Ironically, at least one witness noted that Advisory Opinion 2012-04A results in fewer audits being conducted because most of the plans fall below 100 participants and are thus not subject to ERISA's audit requirements.

The Council heard testimony regarding two other barriers to MEP formation and adoption in general. First, Ms. Wong and others testified about the "bad apple" rule. They noted that due to the joint and several liability issues under ERISA, the failure of one participating employer to pay contributions in a timely manner or to meet certain other obligations may result in liability to the other participating employers. Second, the scope of each participating employer's duty when selecting a MEP provider is not clear. When a participating employer adopts a MEP, a question arises whether the employer acts as a fiduciary or a settlor and, if it acts as a fiduciary, to what extent it does so. In the single employer context, the adoption of a plan, whether individually designed or a prototype, is a settlor, non-fiduciary act. The implementation of that plan as well as its administration is fiduciary in nature. Thus, as explained earlier in this report, the employer sponsor or other named fiduciary engages service providers, selects investment funds and is ultimately responsible for plan administration functions. In the MEP context, the line between non-fiduciary and fiduciary functions is blurred because when the participating employer adopts the plan it accomplishes all of these tasks.

3. Areas Where MEP Administration/operation Can Be Improved.

Based upon the testimony, the Council believes that MEPs, including open MEPs, may prove helpful in increasing retirement plan coverage of employees who work for small businesses. The Council recommends that the Department take several actions with respect to MEPs, including: (i) consider the benefits of multiple employer arrangements in facilitating plan formation in rulings and interpretations; (ii) consider developing a sample structure for MEPs that will help ensure that conflicts of interest, prohibited transactions, and fiduciary independence and disclosure are in place; and (iii) develop safe harbors for MEP sponsors and adopting employers that would not expose them to liability from acts of non-compliant adopting employers.

The Council believes that the MEP structure has merit and that the Department should consider how it may facilitate the use of this structure in situations where the primary purpose of the MEP is the provision of employee retirement benefits. We recognize that the documented abuses that occurred in the MEWA marketplace were unacceptable. In these cases, the promoters of these programs accepted contributions from employees and employers, did not pay the health benefits when they became due, and then hid behind a technical reading of the "savings clause" under the preemption provision in Section 514 of ERISA to avoid regulation under state insurance laws. Congress amended ERISA to address these abusive practices. The Council believes that in light of the trust and funding requirements under ERISA applicable to retirement plans, these kinds of abuses prevalent in MEWAs are far less likely to occur. The Council does recognize that there are "bad actors" in the retirement MEP marketplace. In fact, the Department of Justice and the Department of Labor have recently addressed situations involving such bad actors. However,

given the potential advantages of MEPs, the Council recommends that the Department consider how open MEPs may be used, while still protecting the interests of participants and beneficiaries.

This tension between balancing the benefits of outsourcing against potential downsides for participants is most prevalent in the area of vendor oversight. One of the fundamental benefits of a MEP is that the plan sponsor can relieve itself of many of the obligations of plan administration by having those obligations assumed by the MEP sponsor. Where the MEP sponsor is also a vendor, there is clear potential for a conflict of interest. This tension was acknowledged by Norman Stein, testifying on behalf of the Pension Rights Center:

I'm very sympathetic to the point of view of the [MEP sponsors], not to the extent that I think the Department of Labor doesn't have some legitimate concerns with open MEPs, but I think when that kind of arrangement is done well and done professionally and done competently, I think everybody wins. I think it has potential to increase plan sponsorship, it means employees are going to be paying lower fees, they're going to be getting better services, be getting less conflicted services.

You know, I think the legitimate concern with open MEPs is with the bad actors and... there I suppose the ultimate issue is...you weigh the cost of regulation on the good actors and you say how much is that going to hurt against the risk of letting bad actors come in in a not adequately regulated world and, you know, that's a difficult question, but, you know, I think it's a legitimate question...[T]he same features or the same facts that make small employers not good fiduciaries themselves where they need this kind of service are the same kind of facts that make them not really so able to evaluate in some cases the charlatan from the true professional.

The Council had differing views over where this balance should be reached and encourages the Department to be particularly cognizant in developing guidance of both the potential advantages of MEPs and the need to protect the interests of participants and beneficiaries.

We also believes that sponsors of other types of MEP designs also would benefit from guidance from the Department. As stated by Professor Stein, the key is to protect participants from the bad actors, but weigh that against the impact the Department's regulations and other guidance will have on those that are professionals. Guidance from the Department regarding how to structure a MEP that protects against conflicts of interest and prohibited transactions, and promotes true fiduciary independence would be extremely helpful. Finally, the Council recommends that the Department develop safe harbors pursuant to which, if the requirements are met, participating employers in a MEP will not be liable for the bad acts of any single participating employer. We believe that such safe harbors will make MEPs more attractive to potential plan sponsors.

The Council notes that it did not consider or examine multiemployer plans as part of its review of MEPs and similar arrangements. While these plans are similar in that more than one employer participates, a multiemployer plan is qualitatively different because the employer's obligation as an employer is established pursuant to a collective bargaining agreement and is generally limited to making specified contributions to the trust fund. Accordingly, the Council did not view multiemployer plans as a form of "outsourcing" because the plan itself is not

adopted by the employer. Nevertheless, multiemployer plans in the collective bargaining context may offer many of the benefits of MEPs in terms of relieving plan sponsors of the obligations of operating and administering the plan. As such, in connection with the study of MEPs they may be an appropriate topic for consideration.

E. Bonding and Liability Insurance Practices

Since a key issue in outsourcing arrangements is the transfer of risk from plan sponsors to outsourcing service providers, it is important to consider the role that bonding and liability insurance play in outsourcing. While the two areas are often considered together, bonding and liability insurance are quite distinct functions. Bonding is mandated under ERISA and is designed to protect plans against losses associated with fraud and other wrongdoing by persons handling plan assets. Insurance is not required under ERISA and is purchased to protect plan sponsors or service providers from losses incurred in connection with their performance of services on behalf of the plan. However, in the outsourcing context, both functions share the common attribute of providing a potential source of funding to cover losses that may be incurred by a plan as a result of service provider activities.

1. ERISA's Bonding Rules

If a person “handles” plan assets, then the person must be covered by a fidelity bond under ERISA § 412. The plan must be a named insured on the bond and the amount of the bond must be at least 10 percent of funds handled (subject to a minimum of \$1,000 and a maximum of \$500,000 per plan). The statute also includes a number of exclusions from the bonding requirements for banks and insurance companies. The Department developed regulations that were originally issued in 1975 that are still classified as “temporary” and has provided additional guidance in Field Assistance Bulletin 2008-04.

Notwithstanding this guidance, witnesses indicated that there is still considerable confusion over both the persons required to be bonded and the specific activities that require bonding. Updating guidance in the bonding area could help address these areas of confusion.

2. Fiduciary Liability Insurance

While ERISA Section 410(b) permits plans to purchase such liability insurance (subject to recourse in the event of a fiduciary breach), ERISA does not otherwise address liability insurance coverage. However, both plan sponsors and service providers often purchase insurance coverage for liabilities incurred in connection with performing services on behalf of plans. This coverage can be provided under a general liability policy or through specialty lines of coverage.

In selecting insurance coverage, the following are key considerations:

Insurance Carrier. Consider the financial strength of an insurance carrier.

Limit of Liability. Determining the liability limit under the policy involves questions of both insurer capacity and cost.

Cost. Insurance is a risk transfer in which the insured pays a premium now for the potential of a much larger future payout should a covered loss occur. In determining the premium, insurance carriers look at such factors as the type of risk, the potential severity and frequency of a loss, market share and revenue potential.

Scope of Coverage. Scope of coverage is the breadth of coverage provided. In an *ideal* world, one insurance policy would cover all risks. In the *real* world, no single insurance policy can cover every possible risk .

Plan sponsors should consider not only coverage for themselves but coverage for the acts of their service providers. Plan sponsors may also want to consider a service provider's own coverage as an aspect of assessing the financial viability of the service provider. In addition, the fact that a service provider has insurance coverage in place can provide some measure of comfort that the insurance carrier has performed due diligence on the service provider that will support underwriting of the service provider's activities.

While the Council heard limited testimony on the actual market for insurance, witnesses emphasized the complexities involved in assessing both the need and cost for coverage. In many cases, an insurance broker can provide the expertise necessary to assist in making insurance purchase decisions. However, plan sponsors could benefit from more generalized information about the role that insurance can play in mitigating the risks of plan sponsorship and what is available in the market.

IV. CONCLUSION

After hearing witness testimony, reviewing written statements and conducting its own research, the Council believes that the Department can help improve the administration of employee benefit plans by assisting both plan sponsors and service providers in their efforts to outsource services where appropriate. While ERISA provides a basic framework for allocation and delegation of responsibilities under an employee benefit plan, significant gaps remain that could be addressed through additional guidance from the Department. The Council encourages the Department to develop guidance in a manner that provides sufficient flexibility to both plan fiduciaries and service providers to develop service offerings, particularly in areas involving fiduciary-level services, that foster plan formation while at the same time remaining protective of participant rights.