to prevent redundant suits, to be worked out by parties and judges according to the circumstances on a case by case basis."

In *Ramos v. Banner*, applying that standard, the District Court concluded that plaintiffs had failed to take adequate steps to act in a representative capacity. However, the extent to which a plaintiff can satisfy those procedural requirements other than by satisfaction of Rule 23 standards remains an open issue.

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Q & A

401(k) Service Provider Contract Considerations

Jeffrey A. Herman, Esq.

Whether a small plan with only a handful of participants, or a large plan with tens or hundreds of thousands of participants, every 401(k) plan needs to have certain services performed for it. A plan is just a plan. It is in large part implemented by service providers, who operate pursuant to various agreements.

In this Q&A, we will identify several important types of service providers and what to watch out for in their contracts. Plan sponsors and administrators will be better prepared for future negotiations, and will be able to review their existing agreements with a critical eye. ***Jeffrey A. Herman*** *is an attorney with Greensfelder, Hemker & Gale, P.C. in St. Louis, Missouri. He can be reached at 314-241-9090 or* jherman@greensfelder.com.

Q Why should I care about service provider agreements?

A Because of the potential liability that plan sponsors, plan administrators, and plan fiduciaries face! This liability could be to the service providers themselves, to participants and beneficiaries, and/or to the federal government, such as the U.S. Department of Labor or the Internal Revenue Service. As a person or entity with responsibility for a 401(k) plan, you should always be anticipating the worst-case scenario and striving to make sure your agreements will adequately protect the plan in such situations.

Q What types of service providers and agreements does a plan typically have?

A A typical 401(k) plan might have relationships with some or all of the following types of service providers:

- **Third-Party Administrator (TPA)**—A TPA performs some day-to-day responsibilities under a 401(k) plan as delegated to it by the Plan Administrator. The TPA may determine eligibility, calculate what benefits are due, handle benefit claims and appeals, file the Form 5500, and perform other services.
- **Recordkeeper**—A recordkeeper primarily keeps track of participants' accounts and their investments. Often, the same entity that makes an investment platform available to a plan also performs recordkeeping services.
- **Trustees**—A trust for a 401(k) plan is managed by one or more trustees. The trustees may be discretionary (in which case they assume fiduciary liability for their discretionary acts) or directed (in which case they do not). The terms of the relationship will usually be governed by a separate Trust Agreement, although some plan documents include the trust provisions as well.
- **Investment Manager**—Under Section 3(38) of ERISA, an investment manager is a plan fiduciary with the power to manage, acquire, or dispose of plan assets. An investment manager may help draft an Investment Policy Statement for a plan, determine a plan's investment options, review and modify those options, or direct the investment of plan assets (unusual today, as most 401(k) plans are participant-directed).
- **Financial Consultants**—A consultant may perform many of the same functions as an investment manager, such as performing analyses and advising on plan investments, but will not accept any fiduciary responsibility for their services.

In addition to the foregoing, there may be other important service providers, such as accountants, actuaries, and legal services.

Q What legal concerns are there when hiring service providers?

A Let's focus on three concerns in particular: (1) ERISA requirements; (2) excessive fee litigation; and (3) the contract terms.

First, ERISA requires that contracts with service providers be reasonable. Under Section 404(a) of ERISA, plan fiduciaries must discharge their duties "for the exclusive purpose" of providing benefits as well as "defraying *reasonable* expenses of administering the plan." Under Section 408(b)(2) of ERISA, no prohibited transaction occurs under Section 406 if the transaction involves (1) "reasonable compensation" paid under (2) a "reasonable" contract or arrangement.

Generally, whether compensation is reasonable "depends on the particular facts and circumstances of each case." 29 C.F.R. § 2550.408c-2(b)(1). There is no hard-and-fast rule. In contrast, a contract or arrangement with a "covered service provider" can only be reasonable if it complies with certain requirements set forth in 29 C.F.R. § 2550.408b-2 (the regulation is not a safe harbor, and contracts may still be unreasonable for other reasons). Covered service providers (who are subject to the regulation) include anyone acting as a plan fiduciary, investment advisers registered under federal or state law, certain providers of recordkeeping or brokerage services, and pretty much any other service providers being paid indirect compensation from a plan (such as revenue sharing arrangements, commissions, or finders' fees). To be subject to the regulation, service providers must also be reasonably be expected to receive at least $1,000 in direct or indirect compensation from a plan.

Under the regulation, covered service providers must make written disclosures to a responsible plan fiduciary that include, among other details: (1) a description of the services to be provided; (2) whether the services may be provided in a fiduciary capacity or as an investment adviser; and (3) a description of all direct and indirect compensation that will be paid.

Second, 401(k) plan sponsors, administrators, and other fiduciaries have been targeted in excessive fee litigation for over a decade now. It is important that you evaluate the compensation being paid to service providers, investment option fees, recordkeeping costs, and other plan expenditures. You need to know who is being paid, who is paying, how often it is being paid, in what amount, how that amount is calculated, for what services, any other fee-for-service items that will result in additional fees, and any other important information. If the total amount or nature of the compensation being paid to a service provider is unreasonable in light of the services being received, your plan should consider terminating such services and seeking alternatives.

Finally, the terms of the contracts with the service providers matter a great deal! They are not one-size-fits-all boilerplate. The next sections discuss some potential issues to review.

Q What contractual provisions should I pay attention to?

A Obviously, the entire contract is important. Each provision is drafted by one or the other party for a reason. Here, however, we will focus on some specific terms:

- **Description of the Services**—You need to know what, exactly, the service provider is agreeing to do. Make sure the written description is consistent with your plan's expectations and needs. Often, written agreements will place limitations on the services provided, and services in excess of those limitations will incur additional fees or may not be provided at all.
- **Compensation**—Again, you need to know everything about how much is being paid, including what services will incur additional fees, and how the fees will be updated over time. The provider's mandatory disclosures under the ERISA regulation discussed above will help, but it is important that the contract itself be carefully scrutinized as well.
- **Expenses**—This goes along with compensation, but I am including it as a special category to emphasize it. To the extent a service provider seeks to pass on expenses to a plan (or a responsible party), it may significantly increase the overall compensation paid to the provider. For example, if a TPA agrees to print and distribute Summary Plan Descriptions, benefit statements, and other documents, but passes all printing and mailing costs on to the plan, those extra costs could be significant.
- **Indemnity**—One of the main purposes of contracting with service providers is to shift liability onto the service provider in the event mistakes are made. Indemnity provisions are where the rubber meets the road in terms of who is ultimately responsible for what. If a TPA, a Trustee, or a Section 3(38) Investment Manager states that it will perform a certain service—even in a fiduciary capacity—but your plan (or a responsible party) must pay its own *and* the service provider's damages, losses, attorney's fees, etc. when the service provider does something wrong, then what's the point of paying them to perform that service? Your plan is still on the hook.

Common issues we see in indemnity provisions include: (1) a one-sided indemnity provision, whereby the service provider is protected, but not the plan or responsible parties; (2) significantly limiting the circumstances under which the service provider will accept liability, such as only "gross negligence," and omitting other essential circumstances that should result in indemnification, such as ordinary negligence, a breach of the contract, a breach of fiduciary duty (if applicable), fraud, or intentional misconduct; (3) capping the amount of liability the service provider accepts; and/or (4) placing other language that significantly limits the overall protection provided to the plan and responsible parties.

- **Fiduciary Status**—If it is your understanding that the service provider is accepting fiduciary status under

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ERISA in connection with the performance of certain functions, make sure that is the case! The contract should clearly identify when the service provider will be acting in a fiduciary capacity and when it will not.

- **Governing Law**—A common oversight by plans, service providers may operate all over the country. Odds are, your plan is entirely based in one state or is at least primarily administered in one particular state. The agreement, to the extent it is not preempted by federal law, should be governed by the state law that is most relevant to your plan, not to the service provider.
- **Forum Selection**—The worst-case scenario ends in a lawsuit (or possibly binding arbitration). But where will that proceeding occur? If you administer a small 401(k) plan in Nebraska, you do not want to have to sue or be sued in, say, New York. That would be extraordinarily costly and inconvenient and would make a bad situation worse. The best forums are the federal or state courts that are closest to your 401(k) plan. Just be careful not to pick a forum that is traditionally hostile to employers!
- **Attorney's Fees and Costs**—Like indemnity provisions, contracts may have one-sided attorney's fees provisions, under which a responsible party may have to pay the service provider's attorney's fees and costs in certain situations, but not vice versa. The ideal provision will either allow the prevailing party (regardless of who that is) to be awarded its fees and costs, or state that each party is responsible for its own fees and costs.
- **Termination**—To be reasonable, a contract with a service provider must "permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous." 29 C.F.R. § 2550.408b-2(c)(3). In other words, make sure the plan can reasonably get out of the contract if needed. Also, make sure the service provider has to give reasonable notice before terminating the contract. The responsible plan party will need sufficient time to find a replacement service provider, such as 90 days or more, depending on the services.

Q **That sounds nice, but how can I actually get those changes to a contract?**

A You may not be able to! All of these terms are subject to negotiation, which will depend on your plan's leverage and the willingness of the service provider to accept changes.

BENEFITS CORNER

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Large Employers Want to Retain Assets of Retired Participants

An article on the BenefitsPRO website discussed the efforts of T. Rowe Price to discern the attitudes of plan sponsors toward retired plan participants. They were "shocked" when their initial outreach a couple of years ago revealed that the "vast majority" of sponsors wanted their retired participants to stay in their 401(k) plans after retirement. That prompted additional digging, and T. Rowe Price has now released the results of a survey of over 200 401(k) plan sponsors.

Consistent with the initial findings, only 17.8 percent of the sponsors preferred having their retired participants remove their account balances from the plan. About 40 percent had a "clear preference" for retirees remaining in the plan. This survey also revealed a "clear delineation" between sponsors of plans with more than $500 million in assets and those with less. Only 5.7 percent of the larger plan sponsors preferred that retirees roll their 401(k) balances to an IRA or take a lump sum. Conversely, 28.4 percent of the sponsors of smaller plans preferred that retirees take their balances out of the plan.

According to T. Rowe Price, the larger plan sponsors are partly interested in "scale," because larger plan assets provide greater bargaining power with investment providers. The smaller plans are "likely more concerned" with "their ability to provide the administrative support of separated workers."

The survey revealed other motivations, however. Two-thirds of the plan sponsors agreed that ERISA fiduciary protections mean that retirees are better off leaving their funds in the plan rather than rolling them over to an IRA. In addition, three-quarters of the survey respondents agreed that "the likelihood" of lower investment costs available to plan participants was another reason to encourage participants to stay in 401(k) plans. Finally, three-quarters of the surveyed sponsors supported offering "a suite of retirement income solutions," such as systemic withdrawals, managed accounts, stable value funds, bond-laddering strategies, or annuities.

Finally, the survey revealed that nearly 40 percent of the plan sponsors had no clear preference about retention of retiree balances. This group was roughly evenly split between the sponsors of the larger plans and the smaller