



# Creatively Working with Bundled Products

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*Since 401(k) plans have become popular, it is increasingly common for retirement plan sponsors to seek out a single company that can provide them with the full spectrum of plan administration and compliance services. In response, financial institutions have positioned themselves to fill that role by providing bundled service products. However, in our experience, it is common for a gap to arise between the plan sponsor's expectations and the services the bundled providers can give. This gap has led, for several of our clients, to an unhappy situation in which the plan has fallen out of compliance with the law, and each party is pointing fingers at all the other parties in the process.*

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It is important to note at the outset that we do not discourage plan sponsors from using the services of bundled providers to administer their benefit programs. On the contrary, it is common that bundled providers have computer systems and financial networks that enable their participant recordkeeping services to be extraordinary. Nonetheless, bundled providers generally do not take the initiative in assisting plan sponsors in understanding the required services needed for plan administration. It may be appropriate that the plan sponsor itself performs these additional tasks—if he or she just knew what tasks needed doing. Other times, additional professional help is needed to do the things that the bundled provider cannot or does not want to do. In that case, the plan sponsor needs to be able to hire the right people.

This article analyzes why the “one-stop shop” is really an illusory concept, and why that has caused client problems. Furthermore, we share some suggestions that may help to avoid negative results at the outset or to ameliorate them after the fact.

The key to understanding the limits on one-stop-shop services is to examine *what* services need to be provided to the plan, as well as *how* those services will be provided.

## What Services Are Being Provided?

Maintaining a qualified plan's compliance involves a broad spectrum of tasks and responsibilities. The philosophy behind bundled service products is that all those tasks and responsibilities will be handled by a single service provider selected by the plan sponsor. However, in reality, even if the provider wants to fulfill that role, it is often not possible. There are generally three limitations on the ability of the service provider to do everything with regard to the retirement plan: desire, positioning, and expertise.

### Desire

Providers generally do not want to accept all of the responsibilities and liabilities inherent in performing all qualified plan-related tasks.

The best example of this is the “I don't want to be a fiduciary” problem. Service providers usually want to avoid taking on the liability associated with being a plan fiduciary. However, this is not possible if the provider is to perform certain functions for the plan.

The Employee Retirement Income Security Act of 1974 (ERISA), as amended, and regulations and

guidance provided by the Department of Labor (DOL) define “fiduciary” functionally—that is, anyone who exercises the type of discretion normally reserved for a fiduciary is a fiduciary. A fiduciary is anyone who exercises any discretionary authority or control respecting the management of a plan or its assets, provides investment advice for a fee with respect to any assets of a plan, or has any discretionary authority or responsibility in the administration of a plan. [ERISA 3(21)(A)] Fiduciaries owe legal duties to the plan and its participants and are subject to personal liability if they breach those duties and damage participants.

Understandably, service providers generally want to limit this type of exposure by refusing to be fiduciaries with regard to the administration of the plan. Labor regulations specifically provide that performing ministerial tasks, such as applying the plan terms to employee census information to determine who is eligible to participate or to calculate benefits due, or to process claims, does not cause someone to be a fiduciary. [Labor Reg. § 2509.75-8, Q&A D-2] As a result, the tasks that most outside service providers are willing to perform are limited to those that the DOL considers to be “ministerial,” and this produces an outside boundary of what the plan sponsor may expect.

Examples of the kinds of things that bundled providers often refuse to do are determining when forfeitures should be allocated, authorizing cash-outs of terminated participants with accounts of less than \$5,000, and reviewing a domestic relations order to determine if it is a Qualified Domestic Relations Order (QDRO). Some bundled providers will not adjudicate whether a participant may take a distribution, loan, or hardship withdrawal. Others will do so if standards for the decision-making are established by the plan sponsor.

As a result, the nonministerial or substantive functions are left to the ERISA plan administrator, which is usually the plan sponsor or an administrative committee that it appoints. Nonetheless, the average plan sponsor has no idea where the bright line dividing fiduciary and nonfiduciary obligations lies, or what responsibilities it retains.

### **Positioning**

There are situations in which the provider is not (or cannot easily be) in a position to perform certain tasks.

The person who collects census information for plan purposes must have access to payroll and human resource records. The person who decides whether

someone is eligible for a distribution on account of disability must have access to the participant’s medical information and be sufficiently educated to know that this meets the plan’s criteria.

It is a rare bundled provider that is in a position to know this type of information. The bundled provider must secure this information from someone else, such as the plan sponsor’s payroll department or its human resource group. Rarely will a bundled provider be so integrated into the client’s office that it can fully provide these types of services, whether they are ministerial or not.

### **Expertise**

There are times when the provider may not have the technical expertise needed to perform all tasks. Not every bundled provider can perform complex nondiscrimination testing or defined benefit plan funding calculations, or has the flexibility to draft nonprototype legal documents to accommodate oddities in a client’s desired plan provisions. In other words, there are just times where a given bundled provider lacks the know-how to do everything that needs to be done for a plan.

When the bundled provider is not able to fully administer the plan, the responsibility for finding someone who can fill the gaps resides with the plan sponsor or the administrative committee.

All three of the limitations discussed above produce a divergence between the client’s perception of a one-stop shop and what the bundled provider believes to be its responsibilities. If this divergence is not addressed, it will lead to defective plan administration. The defects will not be caused by someone doing something “wrong,” but by the plan sponsor’s lack of awareness of what it needs to do beyond hiring the service provider. Even HR specialists rarely understand the full extent of the responsibilities that are attendant to maintaining a qualified plan. Without help, no plan sponsor will be able to properly ensure that its plan is in compliance.

### **Solutions**

The best solution to the problems discussed above is for the client to become educated about what functions are required to administer a retirement plan and to determine which of those functions will be performed by the service provider. Everything left unallocated to the service provider must be handled by the plan sponsor or administrator, or someone else must

be hired to do that work. This process goes best when someone with ERISA expertise takes the initiative to act as “quarterback.”

Exhibit A is a chart that we have developed to help us perform this analysis for our clients with 401(k) plans. The chart reflects the tasks that we have identified must be performed during a year to administer the plan, with columns for the various service providers. We review the bundled provider’s services agreement to see which of these functions will be handled by that provider, then we help the client identify who else will handle the unassigned tasks.

This chart puts the bundled provider’s services agreement into a perspective that the client can understand. It helps the client understand what responsibilities it retains. It helps us work with the client and the bundled provider to educate the client about what it must do, and to negotiate with the bundled provider about what additional services may be available. In the end, each party knows what its duties are, and what can be expected of the others.

It is also helpful to identify the areas in which the service provider depends on the plan sponsor or administrative committee for information, and then to assist the plan sponsor in understanding that information need. Consider, for example, a 401(k) plan in which ADP/ACP testing is based on compensation earned after the participant enters the plan. Often the plan sponsor gives the bundled provider compensation only from the date of entry. However, both top-heavy minimum benefits and Code Section 415 limitations on account allocations are based on full-year compensation. If the bundled provider customarily receives only partial-year pay for new entrants, a mechanism must be established to enable the bundled provider to get the compensation information it needs to perform the Section 415 and top-heavy analysis, or to arrange for the client (or someone else) to perform these analyses based on the correct compensation.

Again, it is helpful if the ERISA quarterback gets involved here. Someone with expertise should check the data provision procedures at the outset of the service relationship to make sure that they are correct and complete. If the procedures themselves are flawed, the information that is reported will surely contain errors.

Last, it is also helpful for the client to perform proper due diligence about the expertise of the service provider before it is hired to make sure that it can do what is needed for the plan. Different service providers have different strengths—and weaknesses. Some specialize in complex plans; others cater to “plain vanilla”

programs. Some like working with larger plans; others are positioned to handle smaller plans. Some companies believe in “hand holding” their clients; others expect the clients to do their jobs with little assistance. Part of the process of selecting a service provider is to make sure that what it does is a good match for what the client needs.

For example, we had a client that was very acquisitive—it bought three new companies within a two-year period and expected to do many more transactions. When this client was looking for a bundled provider for its 401(k) plan, we questioned the candidates extensively about their ability to handle multiple vesting schedules and optional benefit forms (because we were merging several plans together), as well as an attorney-drafted plan (because the plan terms would not be accommodated by a prototype document). A provider that has very little flexibility should not take on this client, and the client should not hire that provider.

Plan sponsors need to know that special expertise costs more. When it is critical that the service provider be able to handle special needs, the deciding factor for who to hire should not be cost. This does not mean that expense is not a factor at all; ERISA permits only reasonable fees to be paid by the plan. Nonetheless, the complex plan cannot expect to pay the same fees as the simple, straightforward program.

Getting this type of information may be easier than it would appear. A proper request for proposal or interview process needs to contain pointed questions about the bundled provider’s expertise and target market. Often, other advisors, such as accountants or attorneys, have experience with bundled providers and can offer a perspective. Asking bundled providers for references may also be helpful.

### **How Are Services Being Provided?**

The Internal Revenue Service has interpreted the Internal Revenue Code and Treasury Regulations to require that a plan be administered according to the terms of the written document. Failure to do so can cause the plan to lose its tax-qualified status. Service provider systems do not always conform easily to a plan document’s terms. Often, plans have special provisions to further a benefit strategy specific to the company that maintains the plan. There may also be “grandfathered” benefits and rights and other unique provisions that arose from events such as the addition of employees hired through an acquisition.

Besides ensuring that the service provider has the expertise to handle these special needs, it is important to ensure that the provider has the tools it needs to do its work. The service provider only sees the information that is provided to it.

As discussed above, properly reporting compensation may be the critical difference between a properly administered plan and a disqualifying failure. Similarly, advising the service provider of employees that are rehires (and not new hires) will lead to proper vesting and eligibility credit. Individuals with benefits from prior plan formulas or vesting schedules may need to have those benefits or vested percentages grandfathered.

The plan sponsor needs to be an active participant in ensuring that the administrative services are properly provided. It needs to understand that the “garbage in, garbage out” philosophy applies to qualified plans.

If the plan document is not a prototype sponsored by the service provider, it is possible that there is a disconnect between the computerized administration and what the plan document requires. These problems particularly arise in the areas of nondiscrimination testing and corrections. It is possible that methods may be used—often automatically—by a computer administration system that are not authorized by the plan document.

## Solutions

The solution to the above problems is for the service provider to assist the employer in understanding the information it needs to properly do its job. If the

service provider needs the plan sponsor to perform certain tasks, it needs to be proactive in helping the responsible party at the sponsor’s office understand those needs.

Similarly, it is helpful if the attorney who drafted the plan discusses the plan provisions with the people that will be translating those provisions into action. Sometimes the service provider will articulate a valid reason why the plan should not be written to include certain hard-to-administer provisions, or why other options fit the plan’s needs better. Preferably, this can occur before the plan is put into effect or the amendment is adopted.

## Conclusion

Bundling administrative services may provide plan sponsors with an effective, efficient, and a cost-effective way to maintain the plan. However, it is critical that the plan sponsor or its advisors understand what services are being provided, who is providing those services, and what responsibilities it retains. Furthermore, having a good understanding of what the service providers need to know will enable the plan sponsor to give those it hires the tools they need to do good work.

Everyone’s main goal in this process is to have a well-administered plan. Failure to do this subjects everyone to difficulties, including soured client relationships and even lawsuits. Everyone is best served if one or more of the service providers takes the laboring oar to help the plan sponsor understand “who’s on first.”

**ADMINISTRATIVE DUTIES**  
**Plan Sponsor, Inc. Retirement Savings Plan**  
**December 31, 2001**

*Please review the assignment of responsibility for the administration of the plan and indicate any changes.*

	Plan Sponsor	Bundled Provider	CPA	Lawyer	Other Consultant
<b>I. Plan Financial Reporting</b>					
1. Balance sheet / income statement					
2. Audit					
3. Prohibited transaction determination					
4. Prepare Forms 5330					
5. UBIT determination/Form 990T					
6. Market value of assets					
<b>II. Enrollment of Participants</b>					
7. Provide census information prior to each entry date to determine eligibility					
8. Evaluate eligibility to enter on each entry date					
9. Provide enrollment forms to eligible employee					
10. Provide SPD to participant					
11. Provide completed enrollment forms to fund holder					
12. Retain copies of beneficiary designations					
<b>III. Contribution Determination</b>					
13. Provide census information to determine contribution, vesting					
14. Determine employees eligible to participate in contribution allocation					
15. Determine amount of matching contribution for each participant					
16. Determine amount of gross-up matching contribution at year-end (if any)					
17. Determine amount of profit sharing contribution for each participant					
18. Calculate top-heavy minimum (if applicable)					
19. Determine maximum contribution under IRC § 415					
<b>IV. Other Allocations</b>					
20. Determine vesting service					
21. Determine vested percent					
22. Allocation of investment gains/losses					
23. Allocation of contribution					
24. Determination of timing of forfeiture from a participant's account					
25. Determination of timing of use of forfeiture					
26. Reallocate forfeiture (if applicable)					
27. Determination of amount to be contributed based on use of forfeitures to reduce employer contribution (if applicable)					
<b>V. Testing (Other Than 401(k))</b>					
28. IRC § 401(a)(4) Nondiscrimination (other than ADP/ACP tests): contributions; benefits, rights, features; amendments					
29. IRC § 414(s) Compensation					
30. IRC § 410(b) Coverage					
<b>VI. 401(k) Plan</b>					
31. Process salary reduction elections through payroll to ensure proper deferral by participant					
32. Determination of compensation to use for testing					
33. Testing 401(k) [ADP] and 401(m) [ACP]					
34. If 401(k)/(m) test failed, determine amount to be refunded, distributions, and forfeitures for HCEs or QNEC to be deposited					
35. Process refunds of excess amounts to HCEs					
36. Prepare Forms 1099R for participants to report refunds					

**ADMINISTRATIVE DUTIES**  
(Continued)

*Please review the assignment of responsibility for the administration of the plan and indicate any changes.*

	Plan Sponsor	Bundled Provider	CPA	Lawyer	Other Consultant
37. Prepare Form 5330 for excise tax on excess deferrals					
38. Ensure deposits of salary deferrals are made to fund holder within time permitted by Department of Labor					
39. If safe harbor plan, issue annual safe harbor notice to participants 60 days before plan year beginning					
<b>VII. Distributions of Benefits</b>					
40. Provision of election forms to participant					
41. Review of election forms to see if fully completed and signed by appropriate parties					
42. Evaluation of eligibility to receive a distribution					
43. Confirmation of vested interest on termination of employment					
44. Determination of amount to be distributed					
45. Income tax withholding deposit and IRS reporting					
46. Form 1099R provided to participant and IRS					
47. Determination of cash-out amounts for the year (i.e., accounts for terminated participants with less than \$5,000 value)					
48. Send election forms to potential cash-out participants					
49. Make cash-out distributions					
50. If hardship distribution, evaluation of eligibility for hardship					
51. If hardship distribution, confirmation that deferrals have ceased for 12 months (6 months after EGTRRA)					
52. If hardship distribution, solicit new deferral election after end of 12 months (6 months after EGTRRA)					
53. Evaluation of proposed QDRO to determine if it qualifies as such					
54. Segregation of account/initiation of distribution to alternate payee					
<b>VIII. Participant Communications</b>					
55. Preparation of Summary Annual Report					
56. Provision of SAR to participants					
57. Preparation of benefit statements					
58. Provision of benefit statements to participants					
<b>IX. Government Reporting</b>					
59. Form 5500 preparation					
60. Schedule A					
61. Schedule B					
62. Schedule C					
63. Schedule D					
64. Schedule E					
65. Schedule F					
66. Schedule G					
67. Schedule H					
68. Schedule I					
69. Schedule P					
70. Schedule R					
71. Schedule SSA					
72. Schedule T					
73. Preparation of Form 5558 Extension for filing Form 5500 (if needed)					
74. Attachment of Financial Statement Audit to Form 5500 filing					
75. Filing Form 5500 with the DOL					

**ADMINISTRATIVE DUTIES**  
(Continued)

*Please review the assignment of responsibility for the administration of the plan and indicate any changes.*

	Plan Sponsor	Bundled Provider	CPA	Lawyer	Other Consultant
<b>X. Miscellaneous Annual Duties</b>					
76. Top-heavy analysis					
77. Preparation of board minutes outlining contributions to the plans					
78. Determination of whether a given employee is "participating" in a qualified plan for purposes of Form W-2					
<b>XI. Participant Loan</b>					
79. Preparation of loan document (i.e., promissory note, Reg Z statement, etc.) for participant					
80. Determination of maximum amount that may be borrowed					
81. Confirmation of proper completion of loan application					
82. Approval of loan					
83. Initiation of payroll deduction for loan payment					
84. Identification of fully repaid loan and termination of payroll deduction					
85. Provision to terminated participant of information on repayment of loan					
86. Provision of notice of delinquency to participant, plan sponsor					
87. Determination of timing of default and offset of loan					
88. Preparation of Form 1099R on defaulted loan					
<b>XII. Miscellaneous</b>					
89. Determination that a 5 percent shareholder or a terminated employee is required to begin taking minimum distributions (at age 70 1/2)					
90. Determination of minimum distribution amount					
91. "Point person" for participant questions regarding plan operations					
92. "Point person" for participant questions regarding plan investments					
93. "Point person" for fund holder questions regarding plan operations					
94. "Point person" for identifying changes in the law that impact the plan					
<b>XIII. Plan Qualification</b>					
95. Plan document and amendments					
96. Loan procedure					
97. QDRO procedure					
98. Summary plan description					
99. Designation of beneficiary					
100. IRS favorable determination letter submissions					
<b>XIV. Administrative Master Forms</b>					
101. Enrollment form/deferral elections					
102. Beneficiary notice and designation					
103. Distribution notices and elections					
104. Investment elections					
105. Loan documentation					
<b>XV. Plan Assets</b>					
106. Investment policy					
107. ERISA § 404(c) compliance					
108. Prospectus on file					
109. Evaluation of investment options					
110. Employee education on investments					
111. Annual review of investment option performance					