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Conducting Effective Service Provider RFPs for ERISA Retirement Plans

Crafting Comprehensive Proposals to Meet Fiduciary Duties and to Avoid Litigation and DOL Audits

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Applicable Law and DOL Guidance



Overview

- Background principles and applicable law
- The RFP Process – beginning, middle and end
 - Selected considerations for the RFP process
- The RFP Process and Negotiation of the Service Provider Agreement

Applicable Law – Fiduciary Status

- ERISA § 3(21):
 - Fiduciary status is based on the **functions performed for the plan**, not just a person’s title; functional test for fiduciary status
 - The selection of service providers for a plan, including the selection of fiduciaries, is an exercise of discretionary authority or control over the management and administration of a plan within the meaning of Section 3(21) and is therefore a fiduciary act subject to the general fiduciary standards.

Applicable Law – Fiduciary Obligations

- ERISA's fiduciary obligations:
 - Act solely in the interest of plan participants and their beneficiaries with the exclusive purpose of providing benefits to them
 - Carry out duties prudently
 - Follow plan documents (unless inconsistent with ERISA)
 - Diversify plan investments; and
 - Pay only reasonable plan expenses

Applicable Law – Fiduciary Liability

- **Fiduciary liability:**
 - Fiduciaries who do not follow ERISA’s fiduciary obligations may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of the plan’s assets resulting from their actions.
 - Consider co-fiduciary liability.

Applicable Law – Fiduciary Standard

- ERISA § 404(a)
 - “care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims”
 - “Procedural prudence”
 - Practical analysis
 - Documentation that demonstrates process and awareness of fiduciary responsibilities and obligations

Applicable Law – Procedural Prudence and RFPs

- Putting “procedural prudence” into action; a formal RFP process
 - Survey potential providers
 - Ask the same information from each provider and provide the same information to each provider
 - Create a paper trail (document the process) and make a meaningful comparison and selection
- Procedural process can help limit fiduciary liability

Applicable Law – Procedural Prudence

- Procedural prudence (cont'd):
 - RFP questionnaire should elicit information to assist plan fiduciaries with demonstrating procedural prudence, e.g., information concerning:
 - Qualifications of service provider
 - Quality of work product
 - Fees/cost of services provided (note: cannot be sole determinative factor)
 - Access to service provider
 - Dispute resolution process

Applicable Law – Prohibited Transactions

- Prohibited Transactions:
 - “per se” prohibited transactions
 - Section 408(b)(2) exemption
 - Contract or arrangement must be reasonable
 - Services are necessary for the establishment or operation of the plan
 - No more than reasonable compensation is paid for the services
 - Self-dealing/conflict of interest prohibited transactions

Applicable Law – Prohibited Transactions/Conflicts of Interest

- Conflicts of Interest/Self-dealing prohibited transactions
 - RFP process should elicit information about potential conflicts of interest
 - Examples:
 - Company president offered favorable financing for company loans if hires bank as custodian for company 401(k) plan
 - Plan investment manager sends plan fiduciary on expensive vacations
 - Law firm moves 401(k) plan to trust company in return for legal work

Applicable Law – Conflicts of Interest

- Conflicts of interest:
 - Caselaw:
 - Chao v. Linder, No. 05C2812, 2007 WL 1655 254 (N.D. Ill, May 31, 2017)
 - Brink. v. DaLesio, 496 F.Supp. 1350, 1368 (D. Md. 1980), aff'd in part and rev'd in part, 667 F.2d 420 (4th Cir. 1981)
 - Patelco Credit Union v. Sahni, 262 F.3d 897 (9th Cir. 2001)
 - Violation of fiduciary rules and self-dealing prohibited transaction

Applicable Law – Putting it Together/DOL Guidance

- DOL guidance on fiduciary responsibilities and selection of service providers:
 - IB 75-8, FR-17
 - Information Letter issued to Theodore Konshak (December 1, 1997)
 - Information Letter to Diana Ceresi (February 19, 1998)
 - Advisory Opinion 2002-08A
 - Field Assistance Bulletin 2007-01

Applicable Law– DOL Guidance

- DOL online guidance:
 - DOL Report of the Working Group on Guidance in Selecting and Monitoring of Service Providers <http://www.dol.gov/ebsa/publications/srvpro.htm>
 - Meeting Your Fiduciary Responsibilities <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.htm>
 - Tips for Selecting and Monitoring Service Providers for Your Employee Benefit Plan <http://www.dol.gov/ebsa/newsroom/fs052505.html>

Applicable Law – DOL Guidance

- DOL online guidance (cont'd):
 - Selecting and Monitoring Pension Consultants
 - Tips for Plan Fiduciaries
<http://www.dol.gov/ebsa/newsroom/fs053105.html>
 - Outsourcing Employee Benefit Plan Services
<http://www.dol.gov/ebsa/publications/2014ACr eport3.html>

Requests for Proposals: Selected Best Practices

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Introduction

When a plan fiduciary is about to engage another fiduciary or a service provider for the plan, it is often a good idea to use a formal RFP process to solicit candidates, and to assess the number of available candidates, their relative costs, and what each brings to the table. It is necessary to clearly identify the scope and nature of the project, as clear expectations lead to an easier implementation.

Description of Expected Engagement

- In considering the likely duties, tasks and/or services for which a fiduciary or service provider is to be engaged, it is important to:
 - Identify those tasks and services that are critical;
 - Identify those tasks and services that would be nice to have but are not critical.
- If there have been issues regarding the performance of a current or prior vendor, the requirements and questions should be drafted to elicit information as to whether the same issues could arise with the new vendor.

Experience and Expertise

- Information requests should solicit experience and expertise a vendor has with respect to the tasks and services identified.
 - The RFP should request resumes for all individuals who will be assigned to the project.
 - The structure of the responding entity may be very important, to determine if the vendor is of a size appropriate to the project and has the right personnel and resources to handle the work.
 - How many similar projects has vendor done?
- Be clear that ERISA-based experience is sought.

Staffing – Personnel

- Request information regarding the expected staffing of the engagement:
 - Who will be assigned to the project? Names and titles of senior and mid-level people should be provided, along with their credentials.
 - What is each senior person’s specific relevant experience? What is the background of the staffers likely to be assigned as the project moves forward?
 - How available will the assigned individuals be? What back-up will be provided if those individuals are unavailable? Will backup contact information be provided for the assigned individuals?

Staffing – Turnover

- What is the vendor's employee turnover rate? This can be crucial information in evaluating the likely day-to-day support from the vendor.
 - A high turnover rate can have a negative impact on the services because problems can arise when switching from one vendor employee to another.
 - A low employee turnover rate can often be indicative of an organization's stability, but this depends on many factors. (Some positions are expected to be staffed with high-quality personnel on their way up, for example, and too much stability in those cases might indicate use of lower-quality personnel.)

Compliance Questions

- Fiduciary issuing RFP must assess whether various ERISA and other requirements are met.
 - If the vendor will be handling plan assets, are the vendor and its employees bonded?
 - If various staffing functions must or should be provided by licensed individuals (attorneys, accountants, actuaries, investment managers, or advisors), are those individuals properly licensed?
 - Will work they are responsible for be performed by the individuals with the licenses or by non-licensed individuals?
 - Is vendor or any personnel barred from working with ERISA plans?
- Is vendor audited or susceptible to be audited?

Vendor Practices and Protocols

- It is important to identify vendor's needs and requirements:
 - What are vendor's requirements for the timing and substance of information from plan fiduciaries, to enable it to perform the tasks and services for which it is being engaged?
- How often does the vendor communicate with its clients?
- Are additional services available to meet unexpected needs and circumstances?

References

- At least three references should always be requested. This allows fiduciary issuing RFP to get outside information as to the vendor's performance and the types of experience it has.
- References may be requested regarding similar projects within a stated period of time (such as the past 5 years) or regarding specific types of projects. This helps to ensure that relevant experience, as judged by sources outside of vendor, is current and significant.
- References should demonstrate ERISA experience.

Protection of Plan

- The RFP should ask if there is a conflict of interest that might interfere with vendor's sole loyalty to plan.
 - This may require that names be provided to the vendor to enable conflict check.
- Information should be requested or demanded as to professional liability insurance.
 - Will vendor expect caps on amount, events, or standards triggering liability? Ordinary negligence is a common exclusion from vendor liability, but liability for fraud and willful misconduct cannot be excluded.

Fees

- Fees are a critical component of an RFP. How are fees determined?
 - Flat fee for project?
 - Hourly? If so, what are rates for various individuals?
 - What are the expected hours, or is there a cap?
 - Asset-based? If so, what assets count?
 - Per participant? If so, what participants count?
 - Pursuant to a fee schedule for specific tasks?
 - Are there charges for photocopying, mailing, etc., or other expected service components?
- Are fees ERISA-compliant?
 - Will vendor receive revenue sharing?

Contract Provisions

- Sample Contract:
 - If applicable, ask vendor if it has a sample contract that it will require or offer.
 - If fiduciary issuing RFP has a specific form contract, consider attaching it to RFP.
- Determine content of boilerplate provisions:
 - Indemnification
 - Arbitration
 - Short statute of limitation
 - Time limit on review of accounts or other information
- Be sure provisions are ERISA-compliant.

Responding to an RFP

- A timeline for responding to the RFP should be clearly stated in the RFP. For example:
 - Any questions should be directed to a specified individual before a specified date.
 - Applications must be mailed (or received – specify which) no later than a specified date. State that applications will not be accepted after this date.
- If desired, state that invitations for interviews will be issued by specified date, and final decision will be made by specified date, but don't bind fiduciary unnecessarily.

Transition

- Create a timeline in RFP for accomplishing a task or for transition to new vendor.
- Will transition documents be needed, such as a detailed business requirements document?
- In what format will existing plan information need to be transferred to new vendor?
- Will new vendor have cooperation of current service provider?
- Will vendor cooperate with future replacement at termination of engagement?

Rules for the RFP Process

- The RFP may prohibit contacting individuals related to the plan other than those handling the RFP process.
 - Contains information that a search is underway and controls what prospective vendors are told.
 - Prevents some vendors from having extra information not available to other potential vendors.
- RFP should reserve the right to make a decision based on its evaluation of each proposal. It should be clear that there is no obligation to accept any proposal.

Affirmative Action

- If affirmative action is a concern, questions should be asked about equal opportunity hiring and staffing.
 - Is the vendor woman or minority owned?

Case Study – Selection of Independent Fiduciary for ESOP Transaction

- Obtain list of candidates in the business
- Determine candidates to be approached
 - Institution vs. individual vs. small company
- Determine ideal credentials
 - Favorably viewed by DOL a plus
 - Knowledge, experience and reputation critical
- Identify fee structures for candidates
 - Fixed fee for project common
 - But needs will certainly evolve through project

Case Study – Selection of Independent Fiduciary for ESOP Transaction

- What extra costs will be involved?
 - Cost of Independent Fiduciary’s Counsel a constant
 - Some candidates can be own counsel
 - But most will want recognized counsel
 - Highly regarded Independent Fiduciary will often want name-firm counsel
 - Many will want counsel they have worked with before
 - Counsel fees often as high as Independent Fiduciary’s fee
- Must be monitored – how will that work?
 - Who will do it, and will there be a conflict of interest?
 - Who would terminate, if necessary?

Important Information

This presentation is intended for general informational purposes only, and it does not constitute legal, tax, or investment advice from The Wagner Law Group. Financial advisors and other plan service providers should consult with their own legal counsel to understand the nature and scope of their responsibilities under ERISA and other applicable law.



Conducting Effective Service Provider RFPs for ERISA Retirement Plans

Part III: How can my company obtain enhanced contractual provisions in the agreements with our service providers?

Andrew Douglass

Background and Basics

- **Current State of Retirement Plan Services Industry**
 - Significant consolidation of service providers in recent years
 - Erosion of traditional sources of revenue for providers
 - Greater emphasis on possible ERISA fiduciary status
- **More important than ever to ensure that scope of services and pricing commitments received from the provider during the RFP process are memorialized into the “four corners” of the contract**
- **Address open issues around key commercial terms (e.g., indemnification) and other “sticking points” in contract**
 - Providers typically add caveats into their RFP responses that need to be addressed during contract negotiation phase
 - Determine your “Must Have” vs. “Nice to Have” provisions

Common “Sticking Points” For Service Provider Agreements

- Scope of services and reasonableness of fees
- ERISA Section 408(b)(2) compensation/fee disclosures
- Acknowledgment of ERISA fiduciary status (if appropriate)
- Indemnification and liability caps
- Provider subcontracting, outsourcing, and use of affiliates
- Contract assignment provisions
- Ownership of plan data and records
- Audit rights
- Compliance with company’s policies for outside vendors (e.g., code of conduct, business ethics, diversity requirements, data/IP security, and bonding/licensing/insurance)
- Termination provisions and other remedial rights

Scope of Provider's Services and Reasonableness of Fees

- Confirm specific services/administrative roles to be performed by the provider vs. to be performed by the company
- Review reasonableness of all fees
 - Confirm which fees will be paid from plan assets and fee practices to be used (per capita, pro rata based on assets, individual account fees)
- Review restrictions around provider's ability to change services or fees in the future
 - Be careful with broad caveats or other discretion under contract that allows provider to unilaterally change services or fees
- Confirm applicable deadlines by which certain services must be performed by the provider (e.g., nondiscrimination testing and corrective refunds, Form 5500 reporting, 1099-R reporting)

ERISA Section 408(b)(2) Compensation and Fee Disclosures

- ERISA Section 408(b)(2) allows compensation to be paid to a plan service provider, but only if the:
 - Arrangement/contract between the parties is reasonable
 - Services are necessary to establish and operate the plan
 - No more than reasonable compensation is paid
- Best practice is for all required 408(b)(2) compensation/fee disclosures and acknowledgements from the provider to be clearly documented in the services agreement
- If required, the service provider must describe all direct and indirect compensation to be received by the provider, its affiliates, or subcontractors
- Consider asking for straight rep from provider that all required disclosures have been given and that provider will continue to comply with ERISA Section 408(b)(2) disclosure rules

Acknowledgment of ERISA Fiduciary Status

- ERISA fiduciary status is based on the specific functions performed by the provider for the plan
 - If provider is serving (or arguably serving) as an ERISA fiduciary, standard of care in the contract should reference the “care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims”
 - Even if provider believes that it is acting in only a ministerial capacity to the plan, consider negotiating a similar standard of care anyway and trying to limit any contract language disavowing fiduciary status
- For any provider serving as a trustee, investment advisor/manager or other fiduciary to the plan, contract should have express acknowledgment of ERISA fiduciary status
- Recent finalization of new DOL fiduciary rules for investment brokers and advisors should also be kept in mind!

Indemnification and Liability Caps

- Many providers try to limit their indemnification obligations and place caps on their liability under the contract, such as:
 - Gross negligence vs. ordinary negligence standard for indemnification obligations
 - Liability caps based on multiples of annual fees paid to the provider
- DOL has said that companies should consider any such limitations before entering into contracts with providers
- Generally speaking, the “ideal” indemnification obligation of a provider should be un-capped and apply to breach of any applicable fiduciary obligation/standard of care, breach of the services agreement, or failure to comply with applicable law
- Liability caps should be as limited as possible
 - Consider negotiating carve-outs to caps for indemnified claims, data breaches, overpayments, and other common error situations

Provider Subcontracting, Outsourcing, and Use of Affiliates

- Deals with provider's rights to provide services through other arrangements and vendors
 - Contract language allowing broad discretion to the provider should be reviewed and limited if possible
 - Potentially impacts member experience and service expectations
- Consider negotiation of limitations on provider's rights
 - Contract should capture all potential services and vendors
 - Definitions of "outsourcing," "offshoring," "subcontracting," and "affiliates" should be broadly defined to capture all possible activities
 - Reasonable advance notice and approval rights (e.g., company's consent not to be unreasonably withheld if provider wishes to make changes)
 - Consider "Core services" versus "Non-Core services" approach in allowing provider to make changes
 - Express acknowledgement from provider that it will remain liable for the acts of any subcontractors, outsourcing entities, or affiliates

Contract Assignment Provisions

- Provider typically wants wide latitude to assign the contract to its successors or affiliates
 - Proposed contract language usually is not mutual (i.e., Company's rights to assign are usually more limited than those of provider)
 - Potentially impacts member experience and service expectations
- Consider negotiation of limitations on provider's rights for mutuality of assignment language
 - Assignments within controlled group may be OK as long as assignee agrees expressly to be bound by all contract terms and pricing
 - Reasonable advance notice and approval rights for any assignments not otherwise permitted under contract
 - Consent not to be unreasonably withheld
 - Minimum credit worthiness rating of assignee may be appropriate
 - Recommend asking provider whether "something is in the works" for any possible future assignment to another entity

Ownership of Plan Data and Records

- Provider typically wants broad rights under the contract to use individual participant data and de-identified data for other purposes, such as for:
 - Providers often want data rights to engage in marketing, benchmarking, and educational activities
- Consider negotiation of limitations on provider's rights
 - Contract should specify clear ownership rights of the data (i.e., data and any derivatives)
 - Express prohibitions on any uses not otherwise permitted specifically in contract
 - Unabridged ability of the company to access data
 - Ability of company to port data after termination
 - Clarity around reasonableness of provider's fees relating to data rights

Audit Rights

- Provider typically wants to limit the company's audit rights under the agreement with restrictions on key items, such as:
 - Company's choice of auditor
 - Look-back periods
 - Scope of audit
 - Confidentiality obligations
- Consider negotiation for greater audit rights to ensure that provider's services and fees are reasonable and in accordance with contract terms
 - Company should have complete discretion for choice of auditor (absent any true legal conflict between the auditor and the provider)
 - Review of all fee, compensation, and pricing agreements relating to the provider's services under the agreement
 - Timeframes for the audits should be reasonable and allow look-back to prior years

Compliance with Company's Policies for Outside Vendors

- Many companies require their outside vendors to comply with company-specific policies, such as:
 - Code of conduct and business ethics policies
 - Workforce diversity requirements
 - Data and IP security protocols
 - Minimum requirements for bonding, licensing, and commercial insurance coverage
- Providers are typically resistant to incorporating company-specific policies into the services agreement
 - Some providers argue that their own policies on these areas are sufficient
 - Company may want to request copies of the provider's policies
 - May be possible to negotiate rep that provider will substantially comply with company-specific policies (or will comply in all material respects)

Termination Provisions and Other Remedial Rights

- Provider typically wants to limit company's ability to terminate the contract and/or have other remedial rights
- Consider negotiation of more balanced provisions
 - “Termination of convenience” provision with reasonable advance written notice period
 - Be careful with “evergreen” and other automatic renewal provisions
 - Reasonable “cure period” for inadvertent failure to pay provider's fees
 - Offset and other equitable/termination rights in case of errors by vendor that cause overpayments of fees, damages, fines, penalties, and other damages to the plan and/or plan participants
 - Termination rights for provider's changes in fees or services
 - Termination rights for provider bankruptcy or other business reorganization

Thank You

- Thank you to Sarah E. Downie for contributing to the materials for this webinar.
- Thank you for your attention.

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