# The importance of engaging a 3(16) plan administrator in a complicated, litigious world

Sponsors of retirement plans, particularly 401(k) plans, have been barraged for many years by information about the duties and burdens of maintaining these plans. The word “fiduciary” is thrown around as a sales tactic, a scare tactic, and a fact of retirement plan life. All of this contributes to sponsors’ ongoing fear that, whatever it is they are supposed to be doing, they are either not doing it, or they are not doing it right, and the feds are right around the corner waiting to get them.

Enter the “hired administrator.” Commonly called a “3(16)” administrator or delegated plan administrator, these service providers are striving to take some of the legal burdens and liability off the shoulders of plan sponsors. While it appears that these service providers can have value, their existence and their advertising can sometimes confuse plan sponsors even further, as they try to make sense of what these providers actually do for their fees, and whether hiring them lends any real value to either the plan sponsor or their plan participants.

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## The role and responsibility of a plan sponsor

First, let’s put the word “fiduciary” in its proper context. In the retirement plan world, a fiduciary is someone who has taken on (or has been assigned under the plan) the responsibility for either the investments or the administration of the plan. The whole reason why the law assigns the name “fiduciary” to these individuals or entities is to highlight that they have duties to participants in the plan and that they are legally responsible for fulfilling those duties with the highest level of care. Those duties are to operate the plan in the sole interests of the participants and beneficiaries, for the purposes of providing benefits and defraying the costs of the plan. Fiduciaries must act prudently, i.e., carefully, exercising the care and skill of someone who knows what they are doing in the retirement plan world, even if, in reality, they have no such knowledge. Fiduciaries must operate according to the terms of the plan and the law.

**Sponsoring a retirement plan often takes specialized knowledge and adds time-consuming administrative and fiduciary obligations to an employer’s already busy workload.**

Unless you are in the business of administering retirement plans, the burden of sponsoring a plan may seem overwhelming. Is it just you?

No, it's not just you. The law surrounding retirement plans is complex because it involves so many important interests: providing retirement benefits to employees, helping them save for their own retirement, protecting their financial interests from both intentional and accidental depletion, and taking advantage of tax incentives. This means that several governmental organizations are involved, including the Internal Revenue Service ("IRS"), the U.S. Department of Labor ("DOL"), and the Securities and Exchange Commission. In addition, the concepts involved in making retirement money available are often outside the everyday businessperson's knowledge. These include such things as investment techniques and money management, actuarial science, budgeting, and tax planning. There are always plaintiff's lawyers lurking, ready to convince your participants that, whatever you are doing, it's not enough.

You're probably thinking: hey, I'm a (fill in the type of business you are in). What do I know about all this? You're not alone. Even the government doesn't really expect you to know all this. However, you are expected to get education and help where you need it.

## What is a 3(16) administrator?

Because of the complexities of plan administration and calculations, it is almost universal that plan sponsors hire someone to help with these duties. Historically, this help has extended to ensuring that the paperwork and numerical calculations related to the plan are properly handled, from the allocation of dollars to the nondiscrimination testing to the preparation of participant statements to the completion of government filings. These so-called "ministerial duties" usually are performed by service providers (commonly referred to as "third-party administrators" or "TPAs"). Sometimes the provider that performs the TPA duties is also the plan's fundholder and recordkeeper, such as Securian Financial, sometimes it is a stand-alone provider, and, other times, may even be the plan sponsor's accountants or internal staff.

While TPAs commonly fulfill the technical duties of plan administration, the plan sponsor usually is left with the duties related to making decisions about plan operations. These decisions run the gamut from determining who is eligible to participate to providing notices and disclosures to the participants to choosing the various service providers and managing the plan's activities. As the law has become more and more complex over the years, the challenges faced by businesspeople who simply want to provide to their employees with a means of retirement savings have increased. At the same time, as retirement plans have matured, the amount of money involved also has increased, which makes the financial risk to those in the plan (and those who manage the plan) greater.

As a result of the increased responsibility and stress experienced by plan sponsors, a relatively new type of service provider has arisen: that of an appointed fiduciary administrator to help take on some of the burden and liability of the plan's operations. This type of provider is generally referred to as a "3(16)" administrator, after the section of the governing law (the Employee Retirement Income Security Act of 1974, or "ERISA") that defines the plan's Administrator (who is responsible for the plan's administrative operations).

**A 3(16) administrator can help take on some of the administrative burden and fiduciary liability of a plan's operations.**

In general, these services do not stray far from the work that the TPA does in its nonfiduciary capacity. The difference is that the 3(16) administrator does not require final approval – and, therefore, responsibility – from the plan sponsor, but assumes the responsibility and liability for these items. As the TPA often performs the underlying duties related to these functions, the significant difference between this type of administration and regular TPA work is that the 3(16) administrator can be sued by participants and the plan sponsor in federal court for its errors, rather than in state court for malpractice or negligence under the term of its contract. Additionally, the 3(16) administrator can be held liable for any losses to the plan, or its participants, suffered as a result of its breach of duty; a regular TPA may have a lesser level of liability (and is permitted by law to limit that liability significantly).

## What are the types of services a 3(16) can provide?

Securian Financial and TPAs that agree to provide fiduciary 3(16) services can offer a myriad of different services that will take a range of fiduciary tasks off the plan sponsor. Those services can vary based on which of the fiduciary duties it is in the best position to manage. Under some arrangements, the plan sponsor could end up engaging two different providers to accomplish different 3(16) administrative duties. There is no "one-size-fits-all" that works for all plan sponsors. Assessing your needs, and the needs of your plan participants, is the first step to determine which model might serve you best.

Examples of services that could be delegated to the outside 3(16) provider include:

- Signing and filing the Form 5500 on behalf of the plan sponsor
- Approving distributions (i.e., in-service, required minimum distributions)
- Approving participant loans (and setting the applicable interest rate on the loans)
- Approving hardship withdrawals
- Evaluating qualified domestic relations orders ("QDROs") submitted to the plan in relation to divorces of participants (these orders purport to assign part of the participant's account to the former spouse or children of the marriage)
- Approving corrective distribution of salary deferrals if the nondiscrimination testing is failed
- Distributing required notices and disclosures to the participants
- Determining initial eligibility and managing the participant enrollment process
- Calculating and tracking participant vesting

### Choosing the right provider for you

As mentioned above, one of the first things that a plan sponsor needs to do is assess what sort of needs it might have. Certain factors, such as the size and complexity of the plan, may drive a need to engage a provider to fulfill a comprehensive list of administrative fiduciary functions. For example, if the plan has 500 participants and fairly high turnover, there is an abundance of participants needing to be enrolled consistently and distributions that need processing. The volume may be better handled by the recordkeeper, since it has the data readily available and sufficient staff to process the requests.

The plan sponsor's internal staff size, and/or level of technical knowledge with respect to the retirement plan, may also significantly decrease the potential for operational failures or possible fiduciary errors. Admitting that your company may not have the technical "chops" is not something to be embarrassed about. The Internal Revenue Code, ERISA, and regulations issued by both the DOL and the Department of the Treasury are exceptionally complex and challenging to keep up with. A smaller employer rarely will have a retirement plan specialist on staff. Engaging a service provider to perform 3(16) services may offer the participants a technical resource to whom they may ask questions and get the answers they need. For all of these reasons, engaging a TPA or recordkeeper to provide 3(16) services makes sense, both for the benefit of the participants and to reduce the plan sponsor's potential work burden and liability.

One of the duties that will remain on the plan sponsor's shoulders is the obligation to make prudent decisions and to ensure that all fees paid by plan assets are reasonable. To conserve costs, there may be certain functions that the plan sponsor can effectively manage without assistance. For example, if the plan sponsor's population is small enough, it may be able to handle enrollments and distribution of required notices and disclosures. The plan sponsor may want to approve distributions and loans, but is uncomfortable with weighing in on whether a QDRO meets the Code and ERISA requirements. Some TPAs or other vendors may offer a flexible 3(16) service that enables the plan sponsor to select which functions it wishes to delegate.

**One of the duties that will remain on the plan sponsor's shoulders is the obligation to make prudent decisions and to ensure that all fees paid by plan assets are reasonable. 3(16) services may provide value for many plans and therefore can be considered a legitimate plan expense.**

There are also some plan design choices that may work better with the recordkeeper engaged to perform 3(16) services. Automatic Enrollment is one example of a plan design that requires someone to keep a close eye on many moving parts. Failure to timely distribute notices, to timely enroll new participants, or to timely escalate the deferral percentage (if automatic deferral increases are provided for in the document) can create qualification, operational, and financial problems. Engaging a qualified vendor to determine eligibility, distribute the notices, and automatically initiate deferrals or increase deferral rates for affected participants can make this problem disappear for the plan sponsor.

The costs for many of the 3(16) services may be negligible, a few basis points or dollars per participant, and clearly worth the value of the services being provided, which validates it as a legitimate plan expense. Some arrangements allow for the plan sponsor to pay for these services directly, rather than from plan assets. The benefit provided to participants can be as simple as the faster processing that comes with the 3(16) services and increased cyber security protocols to ensure the internet safety of the plan's procedures.

The use of an outside service provider for 3(16) services serves another valuable purpose. If there are any operational failures that occur as part of the fiduciary services being provided, the liability falls on that service provider. So, not only is there a substantial reduction in errors to begin with when a professional is at the helm, but payment for the correction won't necessarily be the responsibility of the plan sponsor.

## Understanding the potential costs of doing it yourself

Unfortunately, neither the courts nor the regulatory agencies grant plan sponsors a gold star for just trying their best. The failure to properly administer a retirement plan can come with some substantial penalties.

The failure to timely submit the annual Form 5500 filing for the plan comes with two potential penalties. The DOL can issue penalty letters in the amount of $40,000 or more; to make matters worse, the IRS sanctions for a deficient filing can be as high as $150,000 for each plan year. For many employers, getting hit with nearly $200,000 in penalties for a single missed filing could significantly affect their bottom line. Engaging a TPA or other service provider to ensure the Form 5500 is prepared, signed, and filed timely is an obvious advantage to using a 3(16) provider.

There are numerous participant notices and disclosures that must be distributed on an annual basis. Not all of them are provided at the same time, and not all of them go to the same group of people. It can be extremely confusing and an error related to these notices can come with substantial financial penalties. For example, a plan sponsor that fails to distribute an automatic enrollment with QDIA notice can be subject to a potential $1,100 per day, per participant penalty. For a plan with 100 participants, that is a mere 10 days late, the potential penalty could be as high as $1,100,000. Ouch.

Identity theft is in the news on a daily basis. The risk from processing distributions and loans is increasing. Professional service providers, such as Securian Financial, have procedures and technology to help prevent improper access to participant accounts. Further, analysis of a domestic relations order to determine its qualified status requires technical knowledge and experience. Failure to properly determine the qualification status of a domestic relations order could result in the incorrect payment of benefits, which could become the liability of the entity that approved the payment. Getting help with all of this from an expert makes solid legal and common sense.

## Not all service providers are created equal

In the marketplace, there are some recordkeepers that are offering certain services, such as the approval of distributions, that look like 3(16) fiduciary services, but are not comprehensive. When a plan sponsor is looking for true legal support from an engaged 3(16) administrator in a fiduciary capacity, you need to specifically ask to see something in writing that the services being provided are fiduciary, and not ministerial, in nature. The key to how this type of vendor is able to provide such services, but not actually operate in a fiduciary capacity, is in the language of the services agreement. Vendors that appear to be acting as 3(16) administrators commonly perform their services only in a ministerial capacity, which is based on criteria/procedures established by the plan sponsor and may be subject to the plan sponsor's approval. This is not the same as a fiduciary using its own discretion and judgment, and the allocation of responsibility and liability for the vendor's failure may not be effective in limiting the employer's risk.

**When looking for true legal support from an engaged 3(16) administrator, there should be something in writing that confirms the services being provided are fiduciary, and not ministerial, in nature.**

This type of arrangement may be all that is needed for a plan sponsor looking to offload just the time-consuming ministerial functions, but willing to retain all financial and fiduciary responsibility. A good example of the type of service that might work well under this model is the mailing of notices/disclosures to participants. If the plan is large enough, the cost and mechanics of mailing paper notices/disclosures, or the coordinating of proper eDisclosure, may be better borne by the recordkeeper. The plan sponsor in that instance may just need to validate that the proper mailings have been sent to fulfill its fiduciary responsibilities.

Bottom line – any TPA or service provider operating in a fiduciary capacity will say so in writing. If they don't, they're not.

## While the 3(16) administrator may be liable for plan administration errors and losses, the plan sponsor retains duty to monitor

The plan sponsor, and primary fiduciary, will always retain the duty to monitor all service providers to ensure that the services being provided are being done with the proper care and diligence. Monitoring should include periodic benchmarking for all service providers to ensure that the fees being charged are reasonable, as required by ERISA Section 408(b)(2).

The engagement and monitoring of a 3(16) service provider should be documented carefully and thoroughly. In recent years, there have been several lawsuits where the proper engagement of the 3(16) service provider insulated the plan sponsor from legal liability. These cases are educational, showing the responsibility and liability that a 3(16) administration may accept.

Two cases in particular highlight the ability of an employer to transfer liability to the 3(16) administrator. In Leventhal v. MandMarblestone Grp, the plan sponsor filed suit against the TPA and plan custodian after criminals posing as the office manager managed to distribute $400,000 without the plan sponsor's knowledge (in this case, the plan sponsor was also the harmed participant). The TPA claims that it was hired in a ministerial capacity only (and is, therefore, not responsible as a fiduciary), while the plan sponsor claims otherwise. While the case is still ongoing (and the court has yet to rule on the contractual relationship between the parties), the main legal takeaway from the court's actions so far is that the plan sponsor may be able to hold the service providers liable if they take on 3(16) responsibilities and then fail to act with the requisite prudence and diligence.

In Bartnett v. Abbott Laboratories, LLC ("Abbott"), Abbott engaged Alight Solutions, LLC ("Alight") as its 3(16) administrative fiduciary. During the course of the plan's administration, $245,000 was stolen from Ms. Bartnett's account (she was a participant) by a criminal. Ms. Barnett filed suit against her employer, Abbott. Abbott successfully defended the lawsuit by proving that it was prudent in engaging Alight and fulfilled its ongoing duties to monitor Alight. So, while Abbott was able to walk away from the lawsuit, Alight remained on the hook to defend its actions or reach a settlement.

These cases also illustrate the duty of the plan sponsor to hire 3(16) administrators wisely and to monitor their performance. Generally under both cases, the court considered whether the delegation to the 3(16) provider was proper (one of the questions that is still outstanding in the Leventhal case), and whether the plan sponsor had failed in its duties to hire and monitor the 3(16) administrator properly.

## Co-fiduciary duty

A plan sponsor engaging a 3(16) administrator also must understand that there is co-fiduciary liability between the parties. While the plan sponsor can hold the service provider accountable if there is any fiduciary breach or operational failure, the 3(16) administrator also owes the plan a duty to keep its eye on plan operations. If a plan sponsor engages in a fiduciary breach, and the 3(16) service provider becomes aware that this occurred, the 3(16) provider has an obligation to take affirmative steps to correct the breach. For example, if the plan sponsor were to fail to remit participant contributions to the plan, the 3(16) administrator ultimately may need to notify both the plan participants and the DOL of the breach.

## Conclusion

There is a myriad of reasons why a plan sponsor may want to engage a service provider to provide 3(16) fiduciary services. While the primary motivation for retaining a 3(16) provider may be the reduction of sponsor's liability for plan errors, there are other benefits to this relationship that may be even more compelling. Using the expertise and technical knowledge of a TPA and/or recordkeeper, such as Securian Financial, can help the plan run more efficiently and provide the plan participants with increased services and timely processing. Outsourcing numerous fiduciary tasks, such as approval of distributions and loans, can provide the plan sponsor with extra time to run its business and fiduciary/legal relief. Having an independent fiduciary may provide the plan participants with confidence that their interest are being protected. As long as the plan sponsor prudently selects and monitors the performance of the 3(16) service provider, it can enjoy the liability protections and other advantages that the relationship can offer.



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