Arnerich Massena
Building Better Portfolios

In Search of a Recordkeeper: Fiduciary Best Practices

Arnerich Massena, Inc.

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Contributors:
Scott Dunbar, JD; Vincent Galindo;
Jillian Perkins; Jacob O'Shaughnessy, CFA;
Chris Van Dyke, CFA, CAIA

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On March 31, 2012, a U.S. District Court for the District of Western Missouri levied a $35.2 million judgment against ABB, Inc. for breach of fiduciary duty. In Tussey vs. ABB, Inc., ABB made a number of missteps that led to the lawsuit and eventual judgment. The defendants included the company (ABB, Inc.), the committees serving the plans, and one executive who was named personally. With the appropriate precautions, this doesn't have to happen to your retirement plan or to you.

What happened to ABB, Inc.?

ABB sponsored two plans, both ERISA 401(k) plans, one for its union employees and one for non-union employees. A large provider acted as recordkeeper for both plans, with recordkeeping fees paid largely through revenue sharing derived from the investment management fees paid by participants of the Plans. While the Court specifically stated that revenue sharing itself was not inherently imprudent, ABB's lack of oversight of these participant-generated assets breached fiduciary responsibility. ABB never calculated the dollar amount of the recordkeeping fees, never benchmarked them, and failed to negotiate rebates as required by their Investment Policy Statement (IPS), even when informed by their consultant that they were overpaying. Furthermore, the Court found that ABB was not concerned with the recordkeeping costs unless they increased ABB expenses or came in the form of hard-dollar fees, which could make the Plans less attractive to employees. In other words, they didn't mind participants paying more, as long as the participants didn't know it. This was the first misstep, resulting in the decision that ABB "violated their fiduciary duties to the Plan and its participants when they failed to monitor recordkeeping costs and negotiate for rebates from [their recordkeeper]." *(Griffith, 2012)*

It gets worse. ABB's revenue sharing agreement provided ABB with reduced costs from their recordkeeper for other corporate services, such as recordkeeping for payroll and health benefits. ABB was using the revenue share, paid by participants, to subsidize other, unrelated services for the company. Not only does this violate ERISA, but it violated their own IPS, which explicitly stated that revenue sharing should be used exclusively to offset costs for Plan participants. This was a second breach.

In 2000, ABB mapped participant assets from the low-cost Vanguard Wellington Fund into a more expensive suite of target-date funds offered by their recordkeeping provider. The Plans' fiduciaries also selected more expensive share classes of funds than the Plans qualified for. Both of these actions resulted in higher costs for participants. Participants' investment management fees paid to the recordkeeper were covering administrative costs for both the 401(k) Plans as well as other non-ERISA plans. In other words, participants were subsidizing unrelated costs. Again, the fiduciaries' decision was not aligned with the Plans' Investment Policy Statements; rather than selecting investments with the interests of participants in mind, the fiduciaries seemed to be focused on reducing explicit hard-dollar charges to participants while using the revenue sharing agreement in a manner that unduly burdened participants.

While Tussey vs. ABB, Inc. is perhaps an extreme case of breach of fiduciary responsibility, and it seems evident in this case that ABB's fiduciaries had some awareness of their wrongdoing, these types of missteps are easy for fiduciaries to make unwittingly and may be quite prevalent. When it comes to partnering with vendors, plan fiduciaries must always keep the best interests of participants and their beneficiaries in mind. And, as plans evolve and change over time, fiduciary prudence is not a one-time decision but an ongoing process.

> "Plan fiduciaries have a duty to select plan service providers prudently, and once service providers are selected, to monitor the quality of their work regularly and to review their compensation periodically to ensure it is reasonable."
>
> *– Miller & Chevalier, 2001*

As participants become more aware of fees as a result of new rules increasing fee disclosure and transparency (and with participants and regulators both on the lookout for litigation opportunities), it's more important than ever for fiduciaries to be cognizant of their responsibilites and liabilities. In this paper, we'll describe the fiduciary best practices that can help prevent and protect against litigation for breach of fiduciary duty as it pertains to selecting and negotiating with providers. Specifically, we'll discuss why it's important to periodically engage in a vendor search and how to lay the foundation for a successful Request for Proposal (RFP) process.

> "If you are a plan sponsor, retirement plan committee member, or other plan fiduciary, the recent ruling and the DOL statements, and the rise of 401(k) fee litigation should cause you to focus more closely on the risk involved in not periodically taking the plan's service provider contracts to market."
>
> *– McKenna Long & Aldridge, 2012*

How can your organization protect itself?

As a plan fiduciary, your fiduciary liability extends to selecting and monitoring the providers who service your plan. You must be able to show that you have engaged in meaningful analysis and comparison of your providers and their fees. While not regulatorily essential, issuing a vendor RFP and engaging in the analysis of the responses has tremendous benefits in terms of reducing fiduciary liability. Additionally, the Department of Labor, in a preamble to 408(b)(2) regulations, assumes that "plans normally conduct RFPs from service providers at least once every three to five years." (*McKenna Long & Aldridge, 2012*)

The RFP process is designed to insure that your provider is giving you the optimal level of service for the price being charged. Periodically conducting an RFP process to evaluate your provider is not only a best practice to demonstrate fiduciary prudence, but more importantly, it is in the best interest of your participants. If your current partner is the best fit for your plan, the RFP process will validate this and provide fiduciary documentation of prudence. If not, it is your responsibility, as a fiduciary, to contract with the firm that proposes the best value proposition for your plan's participants.

Conducting a full RFP has many benefits, including:

- Maximizing cost savings for plan participants: An RFP places your organization in the strongest possible negotiating position, particularly with the current provider. The incumbent knows that it is highly unlikely the plan will change vendors without the RFP process; the process itself thereby spurs them to review their fee structure in order to be more competitive.
- Providing documentation of the execution of prudent fiduciary practice: Periodic RFP searches document the ongoing evaluation of your providers, taking into account current market conditions and any growth of plan assets.
- The RFP process assists committee members in familiarizing themselves with the best practices from the top providers in the industry in order to potentially implement some of these practices for the benefit of participants.

Who conducts the RFP

You have several options in terms of how to undertake the RFP process. You can:

- Do it yourself
- Hire a consultant/advisor to conduct the RFP
- Have your procurement or purchasing division conduct the RFP

> "Even if you do not change service providers as a result of an RFP process, the information gathered could provide useful leverage in renegotiations and, if properly documented, serve as strong evidence that you are satisfying your duty of prudence under ERISA and that the fees paid by the plan are reasonable in light of the services rendered."
>
> *– McKenna Long & Aldridge, 2012*

The advantage to doing it yourself is that you retain maximum control over the process. However, your committee's time and resources may be limited. Hiring an advisor/consultant removes the burden of the process from your committee and allows for professional input into the construction and evaluation of the RFP. It may help insulate the committee from liability, and demonstrates prudence. If you choose to select an advisory partner for the process, keep in mind that the conduction of recordkeeping RFPs is a specialized field; you will want to find a consultant with experience in this field.

Many businesses and governmental organizations have dedicated purchasing or procurement departments. Having this procurement or purchasing division conduct the RFP can help ensure that the RFP complies with all ordinances, rules, and applicable laws. However, you lose some control over the process and may find that this method introduces delays, as the RFP may not be a priority for the division. If you don't choose to have the procurement or purchasing division conduct the RFP process, it is advisable to engage the division at some level to solicit their input. Alternatives would be to have them review the strategy ahead of time and approve the process you intend to use, or to request that they review the process at periodic intervals to make sure that the process complies with all applicable ordinances and rules.

Preparation for the RFP process

As you undertake the project of creating and issuing an RFP and analyzing RFP responses, preparation is key to a successful outcome. Following are initial steps that will help you to make the most of the process:

- Determine the project's goals and objectives
- Identify key constituents and consider their role in the process
- Set minimum qualifications: identify key vendor capabilities and attributes
- Identify and prioritize scoring criteria
- Define project timeline

Determine the project's goals and objectives

This step establishes the foundation for the RFP process. If your goals and objectives are clear, it will set the stage for a much smoother process. If you are uncertain as to what outcome you are seeking, the likelihood of getting off track increases. When you reach the evaluation stage, being able to refer back to the goals and objectives you outlined at the beginning will provide a context for assessment. What are you trying to accomplish for your plan? Some possible objectives include:

- Lower fees
- Enhanced services
- Better transparency
- Improved recordkeeping technology
- Documentation of fiduciary selection process

As part of this step, review your current vendor relationship carefully. Identify issues and challenges with your current vendors — this can assist in identifying future objectives and outlining potential improvements you can request or look for going forward.

Identify key constituents

This may seem self-evident, but can actually turn out to be one of the most vital steps in the RFP preparation. Your participants and their beneficiaries are obviously key constituents to take into consideration. You also likely have several levels of decision-makers on behalf of the plan. For instance, you may have, in addition to voting committee members, board members, advisory committee members, RFP sub-committee members, and union groups, all of whom have opinions and contributions to make to the process. It is essential to bring all key constituents in to the process early on to ensure that everyone is in agreement as to the goals and objectives and way the process will be undertaken.

It is also important to inform and educate the people who influence plan decisions but are not directly involved in the RFP process to reduce the impact of lobbying by providers. They may apply leverage to anyone who has a say in their selection, simply with the intent of improving their chances of being hired, but those being lobbied may not be fully aware of the extent of their fiduciary duty and how easily conflicts of interest can arise. Imagine the following scenario: the CFO of a large organization has not been informed of the RFP process currently being undertaken. The incumbent provider calls the CFO and complains that this process could potentially end their business with the plan. They mention that if this should occur, other areas of the relationship will be impacted. The CFO, uninformed and unsuspecting, quickly assures the incumbent that the relationship is in no danger, and attempts to influence the RFP process so that the incumbent retains the business. The CFO, completely unaware, has just contributed to a breaching of fiduciary duty.

In order to avoid scenarios like the above, you'll want to preemptively make sure that all the people who vote on, can influence, or advise on plan decisions are informed as to their responsibilities to participants, the objectives of the process, the key benefits sought after, and the steps being taken to ensure that decisions will be made in the best interests of participants.

Set minimum qualifications

How do you attract relevant bidders, but limit the field so that you are not overwhelmed by responses? Setting the minimum qualifications allows you to specify what you are looking for and target the RFP request to an appropriate number of responses. Tie this back to your goals and objectives — identify the key vendor capabilities and attributes you are seeking. Some questions to consider:

- How wide a field of providers do you want to attract?
- Do you want your bidders to have plan type-specific expertise (e.g. 401(k) or 457) or simply overall defined contribution experience?
- Do you want your incumbent provider to be able to meet the minimum qualifications?

If your procurement rules allow, you may also want to identify key candidates and either invite only these candidates to respond or target your minimum qualifications to these candidates.

Identify and prioritize scoring criteria

Develop your evaluation and/or scoring system before undergoing the RFP process. Most scoring criteria will be fairly straightforward, but there are some areas that tend to pose difficulties. For example, how will you score references? Will committee members each call all references? Will staff members call references and score them? Will the advisor call references and transcribe the calls for committee members? Consider your options ahead of time. Another area of difficulty is scoring the transition — how do you score your incumbent in this category? Come to an agreement about how you will approach these areas ahead of time, so that they don't cause problems later and potentially open you up to conflicts or confusion.

The "Best and Final Offer" (BAFO) tradition poses another issue to consider and prepare for ahead of time. While allowing finalists the opportunity to make a final offer during the finals presentation can provide an opportunity to save money, this procedure also opens up process questions, as non-finalists may claim that by not providing them the same opportunity, you have introduced unfair bias. Discuss whether you will allow the BAFO process; check with your procurement or purchasing division to find out whether BAFO is allowed and under what circumstances. What procedures must be followed?

Define project timeline

Setting a timeline provides you with the opportunity to both give yourself plenty of time to go through the

Areas of evaluation a vendor RFP can cover

- Firm background
  - Client base
  - Experience
  - Financial status
- Participant services
  - Communications and statements
  - Web interface
  - Phone services
  - On-site education and communication services
- Plan sponsor services
  - Support
  - Technology
  - Process automation
  - Web tools
- Investment flexibility and capabilities
  - Open architecture capability
  - Fund implementation flexibility
  - Fund implementation timing constraints
- Fees and expenses
  - Recordkeeping
  - Investment fees
  - Other fees
  - Fee transparency review
- Transition/conversion
  - Transition planning
  - Transition monitoring
  - Quality control and testing procedures
  - Implementation communication

process, and to ensure that it moves along without delays. For very large plans, or in governmental contexts, you may need to allow at least 12-18 months for the entire RFP process, including conversion, and about 4-6 months for the RFP response and evaluation process.

RFP construction

There exists a wide variety of tools and templates, as well as professional assistance, to help you craft your RFP. Keep in mind that the more you customize the RFP to your organization's plan, the more relevant the information you will receive. Provide information about your plan to encourage responses that are specific rather than general. Communicate your expectations; by narrowing the expected scope of service, you will achieve a more level comparison.

At the same time, you may want to leave some flexibility in the service model to allow providers to make recommendations and offer services they believe may be relevant. Consider including an "additional services" section, in which providers can outline the services they would offer outside of those requested in the scope of services. You may be surprised to discover what providers will include in order to be competitive.

Lastly, there is nothing to be gained from hiding or omitting information about your plan and expectations in the RFP questionnaire. Bidders are practiced at finding ways to modify the contract after the fact as details are revealed, increasing fees unexpectedly. Your RFP should mitigate the potential for these modifications by including all pertinent information and covering the details of the expected service model.

Evaluation, selection, and contract signing

If you have established your minimum qualifications and scoring criteria ahead of time, initial scoring and evaluation should be a smooth process. When selecting finalists, you should limit your selection to only those firms with a legitimate chance of winning the bid. You can make the finalist interview process most valuable and efficient with the following preparations:

- Prepare an agenda in advance. This is your time, not their time; script the topics you'd like to hear about to keep the conversation focused on your needs.
- Identify areas of weakness in each proposal and give vendors the opportunity to make improvements and refinements to their proposals ahead of time.

Of course, the selection process is not over until the contract is signed. Make sure that the contract reflects the fees and services discussed and negotiated. Finally, promote any enhancements of the plan's services to your participants!

Conclusion

As a fiduciary, it is your responsibility to ensure that the plan's vendors are providing the highest and most appropriate level of services at a reasonable fee — ongoing. The most efficient method for ongoing evaluation and assessment of your provider versus other market providers (and to demonstrate this objectively) is to conduct a periodic vendor search via the RFP process. In order to meet your fiduciary responsibility, the process must be designed so that you can demonstrate an objective evaluation and ultimately, selection of the best candidate. Most importantly, considerations that are unrelated to the plan — such as a vendor who reduces fees on other business services or a provider who offers a board member's son a job — cannot be allowed to help determine or in any way conflict with the selection of who services the plan. That decision must be made based solely in the interests of participants and their beneficiaries, particularly if you want to avoid litigation.

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