



3(16) Fiduciary Services Outsourcing A Critical Fiduciary Liability Mitigation Strategy

A WHITE PAPER BY

Pentegra Retirement Services
2 Enterprise Drive, Suite 408
Shelton, CT 06484-4694
800.872.3473 tel 203.925.0674 fax
www.pentegra.com



There are never enough hours in the day for business owners—large, small or in between—to accomplish everything that demands their attention to keep the business running smoothly. And while offering retirement benefits is a high priority for many business owners to attract and retain exceptional employees, the day-to-day stresses of plan administration tend to fall lower on the daily to-do list than other priorities.

Yet, as plan fiduciaries, subject to personal liability for faulty plan management, plan sponsors are ultimately responsible for their plan. For that reason, it is not only a relief but a critical fiduciary liability reduction strategy to consider outsourcing plan administrative functions to an expert known as a “3(16)” fiduciary. A growing number of financial organizations in the industry offer outsourced 3(16) services. However, not all 3(16) fiduciary services are created equal. In today’s increasingly litigious environment, it is imperative for plan sponsors to be educated consumers of 3(16) fiduciary services in order to prudently select a provider that will serve the plan in the best interest of participants and beneficiaries.

Background

Business owners who sponsor retirement plans that cover common law employees are deemed to be plan fiduciaries pursuant to Section 3(16) of the Employee Retirement Income Security Act of 1974 (ERISA). Under ERISA, a 3(16) fiduciary is a “plan administrator,” defined as either the person or entity designated as such under the terms of the governing plan document. Consequently, a 3(16) administrator is a fiduciary of the plan who is responsible for ensuring the plan is operated in compliance with the rules of ERISA and the Internal Revenue Code of 1986 (the “Code”). Think of the 3(16) administrative fiduciary as a retirement plan’s Chief Operating Officer, responsible for the overall operation of the plan and its day-to-day administration.

ERISA says the plan sponsor is the 3(16) administrator by default unless it appoints another entity to assume parts of the role. As fiduciaries, plan sponsors are held to the highest standard of care and must operate their plans in the best interest of participants and beneficiaries. That means their actions with respect to their plans will be judged against the “Prudent Person” rule, which says that all decisions and acts must be carried out “... with the care, skill, prudence, and diligence...” of a knowledgeable person.

The DOL can hold plan sponsors personally liable for failing to fulfill their fiduciary obligations to their plan participants. Plan fiduciaries who fail in their duties can face costly civil and criminal penalties, too. And in rare cases, even jail time. The DOL assumes plan sponsors know what they are doing when it comes to running a plan—and if they don’t—they must seek out competent support or be at risk of a fiduciary breach.





All of this makes a strong argument for seeking expert help in running a qualified retirement plan. ERISA allows plan sponsors to outsource some of their 3(16) fiduciary responsibilities by formally appointing another entity to assume some of their plans' administrative functions. In situations where plan administration is outsourced to another entity, the plan sponsor still retains fiduciary responsibility for prudently selecting and monitoring the 3(16) outsourced solution. It is important to note that a plan sponsor may never fully eliminate its fiduciary oversight responsibilities for the plan.

In truth, many plan sponsors are not only uncomfortable shouldering the full responsibility (and liability) for performing all of the fiduciary functions of a plan administrator because they lack the necessary expertise, they—flat-out—do not have the time necessary to administer the plan as the Department of Labor (DOL) and Internal Revenue Service (IRS) expects. According to a 2022 study by Pentegra, nearly 89 percent of plan sponsors spend up to 50 percent of their time on retirement plan administrative work that could be outsourced, yet less than half of them outsourced these responsibilities. By utilizing a professional 3(16) outsourced solution, not only would plan sponsors be bringing in experts to help run their plans, they would also have more time to focus on areas of their businesses other than plan administration.

A plan sponsor can delegate certain ERISA 3(16) administrative responsibilities, including the following, as well as a whole host of others:

- Required compliance testing
- Plan eligibility notifications
- Approval of participant loans and distributions
- Delivery of required participant notifications and disclosures

A Prudent Solution

There are many good reasons for a plan sponsor to consider hiring a firm that specializes in providing 3(16) administration services including:

- Spending more time on other areas of the business
- Relieving the administrative responsibilities of the business owner's team
- Reducing risk of liability
- Optimizing plan features
- Improving plan and participant retirement outcomes
- Having peace of mind

In fact, up to 50 percent of plan sponsors intend to outsource plan administration in 2023.¹ While small plans outsource their administration the most, plan advisors see all market segments utilizing and benefiting from 3(16) fiduciary outsourcing services. By engaging an outsourced 3(16) plan administrator, a plan sponsor shifts fiduciary responsibility to the 3(16) plan administrator for the services specifically contracted (e.g., plan reporting, participant disclosures, distribution authorization, plan testing, etc.).

Should a plan sponsor decide to engage a 3(16) fiduciary administrator, the selection process must be carried out in a prudent manner and solely in the best interest of the plan participants and beneficiaries. There are a number of firms in the industry that offer 3(16) fiduciary services including

¹ [Pentegra Study, Advisor Attitudes Towards 3\(16\) Fiduciary Outsourcing, 2022](#)

certain third-party administrators (TPAs), trust companies and registered investment advisors (RIAs). But all 3(16) outsourced providers are not created equally.

The DOL requires the plan sponsor to engage in a prudent, objective selection process for a 3(16) outsourced solution designed to elicit the information necessary to answer the following questions:

- What are the qualifications of the service provider (e.g., years in the business, number of clients, etc.)?
- Are the services delivered of high quality or just mediocre?
- What does the provider's service agreement say (e.g., are responsibilities clearly defined, is there an indemnification clause, etc.)?
- Does the provider have a consistent track record of success?
- What is the provider's professional "bench-strength" and tenure of staff?
- Are the fees charged reasonable in light of the services provided? ²

In addition, the selection process should be designed to avoid self-dealing, conflicts of interest or other improper influence.

Beyond the Basics

Most 3(16) providers will offer basic plan administrative services related to compliance testing, plan eligibility, loans and distributions, participant notices and disclosures. Only a few providers go above and beyond offering routine services to offering more comprehensive 3(16) services, like Pentegra does through our "3(16) Fiduciary Overlay Services."

Pentegra is one of the oldest, most experienced independent, institutional fiduciaries in the U.S. As a 3(16) fiduciary, Pentegra provides expert oversight and in-depth knowledge, shouldering much of the work and sharing legal responsibility for managing a retirement plan. In this role, Pentegra focuses on every aspect of a retirement plan, identifying issues that often elude others and saving clients countless hours and significant fines and penalties.

Pentegra's level of service is comprehensive and clearly delineated in the service agreement. The firm:

- Makes plan design recommendations
- Completes all annual government filings,
- Fulfills day-to-day administrative functions (e.g., compliance testing, distributions, plan notices, regular due diligence reviews, ongoing plan monitoring, etc.),
- Participates in plan audits,
- Conducts annual and quarterly check-up meetings and, above all,
- Stands behind its work with a fiduciary warranty.

Not only is Pentegra highly qualified, it makes the outsourcing process easy. Our 3(16) Fiduciary Overlay Services are layered onto existing record-keeping and investment manager arrangements to minimize disruption. As an overlay, all existing trusted relationships stay intact.

² [DOL Advisory Opinion 2002-08A](#) and [DOL Field Assistance Bulletin 2002-3](#)



Pentegra's plan sponsor clients have the assurance of knowing their plan is well designed, well managed, and compliant. In addition, plan sponsors enjoy the confidence of working with experts who are impartial and always put their clients' interests first. Plan sponsors, participants and advisors enjoy a higher level of protection, reduced workloads, lower levels of risk, improved plan outcomes and greater peace of mind when using Pentegra's 3(16) Fiduciary Overlay Services.

Case Studies

The following two examples showcase Pentegra's deep ability to assist plan sponsors through our 3(16) fiduciary services. The first relates to plan documents and the second to governmental reporting. Both areas are critical fiduciary compliance components under ERISA.

It All Starts with the Plan Document

One of the most foundational legal responsibilities of a plan sponsor is to ensure the governing documents for the business's qualified retirement plan are current for all law and regulatory changes. Failure to keep the plan language current could result in disqualification of the plan, resulting in serious tax consequences. For the plan sponsor, plan disqualification could mean loss of tax deductions for contributions and thousands of dollars of potential penalties. For plan participants, plan disqualification could mean the loss of tax-favored status for their contributions and earnings, resulting in unexpected taxable income.

The IRS assists plan sponsors who have adopted an IRS pre-approved plan document with the plan refresh process by routinely requiring them to update their plans according to a "restatement cycle." Each restatement cycle (e.g., six years for defined contribution plans) provides a window for affected employers to adopt an up-to-date plan document. The most recent restatement deadline for pre-approved defined contribution plans was July 31, 2022.

Pentegra discovered, through its work with several pre-approved plan document providers, that a number of plan sponsors had missed the July 31, 2022 plan restatement cycle deadline. As a result, the plans could no longer rely on the IRS's original favorable opinion letters. The IRS now considered the plans "individually designed" and subject to another level of scrutiny. The plans needed to be reviewed to determine if they were in compliance as to form as individually designed plans. Pentegra reviewed the documents, identified those that needed correction and assisted the affected plan sponsors with the appropriate correction process as outlined in the IRS's Employee Plans Compliance Resolution System (EPCRS), thereby preserving each plan's tax-favored status for the plan sponsor and its participants.

Form 5500 Filings Are Not for the Faint of Heart

Employers that sponsor retirement plans for their employees must file the appropriate version of Form 5500, *Annual Return/Report of Employee Benefit Plan*, annually with the DOL and IRS to help document they are maintaining their plans according to prescribed standards under law. Form 5500, with its many schedules and attachments, is complex. Missed, late, incorrect or incomplete filings are common and penalties for noncompliance can be steep. Plans that do not outsource this service to a professional, or outsource this service to an inferior provider, can find themselves in hot water with the government. When there is a failure to properly file Form 5500, plan sponsors can take part in the DOL's Delinquent Filer Voluntary Compliance Program (DFVCP), which is designed to encourage voluntary compliance with the annual reporting requirements.

Pentegra regularly assists with DFVCP submissions for plans it has taken on, and has been able to facilitate material savings for plan sponsors in liability, time, money and frustration. In a recent take-over case for Pentegra, a plan sponsor was facing over \$120,000 in late Form 5500 filing penalties. With Pentegra's help, the plan sponsor voluntarily implemented the corrective measures outlined in the DFVCP, completed a submission, and paid a much more palatable \$750 penalty.

Even in situations where the DFVCP can no longer be used because the plan sponsor has already received a DOL notice regarding a faulty Form 5500 filing, Pentegra's Custom Plan Consultants have developed strategies to lessen the penalty assessment. In one case, Pentegra assisted a plan that received a DOL notice rejecting its Form 5500 filing because the plan sponsor had not included the necessary audit report. The DOL was going to assess a \$50,000 penalty.

The Custom Plan Consultant Team's years of experience led them to conclude the failure clearly fell under the DOL's "reasonable cause" exception to the penalty. Consequently, Pentegra was able to help the plan sponsor draft a letter of reasonable cause, assist with getting the audit done and refile the Form 5500 within the required 45-day correction window. As a result, the DOL lowered its penalty to \$5,000.

Conclusion

More plans sponsors are outsourcing plan administration obligations to outside entities that are willing to assume the responsibilities of an ERISA 3(16) plan administrator. Selecting an outsourced solution is not a decision to be made lightly as the DOL mandates the plan sponsor follow a prudent selection process that looks out for the best interest of the plan participants and beneficiaries. There are a number of 3(16) outsourced providers in the industry. Sadly, however, service levels vary among providers, with few possessing the depth of expertise and professionalism mandated of a plan administrator. Pentegra rises to the call with its comprehensive 3(16) Fiduciary Overlay Services.

Follow us on

