

# The 2014 ERISA Advisory Council

## Executive Summary to The Secretary of Labor

November 4, 2014

### The 2014 ERISA Advisory Council

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### Topics for 2014

- Facilitating Lifetime Plan Participation
- PBM Compensation and Fee Disclosure
- Outsourcing Employee Benefit Plan Services

## Facilitating Lifetime Plan Participation

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## Facilitating Lifetime Plan Participation

### Our Goals:

- Determine how often and why participants decide to remove money from the plan.
- Determine what information is available to participants from plan sponsors and government agencies to assist in the decision to remove money from the plan and what information would be helpful in making that decision.
- Determine what plan design features may increase asset retention within the plan at termination of employment.
- Determine steps the Department of Labor (DOL) can take to facilitate lifetime plan participation.
- Examine the extent to which loans and hardship withdrawals hinder retirement asset accumulation and what can be done about it.

## Facilitating Lifetime Plan Participation

### Findings:

- American workers change jobs as many as 10 times during a 40-year career, resulting in multiple opportunities for plan assets to leave the employer sponsored system:
  - In 2013, 43% of employees took cash distributions at termination. For workers age 20-29 the withdrawal rate was 56%.
- There are various considerations individuals need to weigh when deciding what to do with their account balances upon leaving employment.
  - Government required information is principally the tax notice which is overly legalistic and focuses solely on removing money from the plan.
  - Participants would benefit from receiving practical, useful, and objective information at the time they make their decision.

- Plan sponsors' attitudes around these issues are evolving yet mixed across the industry:
  - Regarding the decision to transfer or leave monies in the plan, plan sponsor communication varies widely with some doing nothing and others providing more decision support and information.
  - Plan sponsors hesitate to provide information because of fiduciary and liability concerns and would benefit from the DOL providing advice and outreach.
- Plan sponsors may be able to increase plan asset retention at termination by making their plan more attractive. Examples could include:
  - Offering more features, such as loan initiation, brokerage and mutual fund windows;
  - Adopting lifetime income options and stable value funds;
  - Allowing participants to consolidate multiple accounts; and
  - Providing access to financial advice.
- The challenges and opportunities identified in the Council's 2012 Report on Retirement Income remain relevant today.
- Loans and hardship withdrawals have varying impacts on leakage issues:
  - Hardship and early withdrawals reduce retirement assets because they are not paid back and are frequently taxed (including applicable early withdrawal penalties).
  - The availability of loans may make willingness to save for retirement more attractive.
  - Loans usually are paid back except when outstanding balances exist at termination and repayment schedules are not allowed to be continued.
  - Making loans available to terminated participants could reduce other forms of leakage but poses administrative challenges.
- Much of the foundational technology underpinning the current system was developed in support of the supplementary, "opt in" approach to DC plans. However, it is clear that much of this framework is outdated and serves as a barrier to further enhancements to the system.
  - Model forms, as well as industry standards for the composition and transmission of information as electronic data, can address processes that are often performed manually and with a great deal of variation across the industry.
  - DOL can help by creating sample forms, as well as by fostering modern technological standards and retooling within the industry.

## Facilitating Lifetime Plan Participation

### Recommendations:

A. The Council recommends that the DOL:

- Provide education and outreach to participants and plan sponsors on the considerations and benefits to participants of retaining assets within the employer-sponsored system, including providing sample educational materials that can be used by plan sponsors at all points of participation in the plan.
- Develop model, plain language communications that can be provided to participants at all points of their participation in the plan, including prior to enrollment and throughout employment, to help them decide what to do with retirement assets, particularly at job change and retirement, or other distribution events.

B. The Council recommends that DOL provide educational outreach and materials to plan sponsors relating to plan features that encourage lifetime participation.

C. The Council recommends that DOL:

- Provide additional guidance to encourage plan sponsors to offer lifetime income options, including an updated defined contribution plan annuity selection safe harbor.
- Look for additional ways to make useful tools available, including DOL's Lifetime Income Calculator ([www.dol.gov/ebsa/regs/lifetimeincomecalculator.html](http://www.dol.gov/ebsa/regs/lifetimeincomecalculator.html)), and integrate existing tools such as those in My Social Security (<http://www.ssa.gov/myaccount/>).

D. The Council recommends that, for plan sponsors who make loans available to participants, DOL should provide information to them to consider allowing continuation of loan repayments after separation from employment. DOL also should point out the advantages of loan initiation post-separation in order to prevent leakage.

E. The Council recommends that DOL should:

- Create uniform sample forms for facilitating plan to plan transfers.
- In cooperation with other agencies, industry groups, and other interested groups, foster technology standards which simplify the electronic transfer and consolidation of accounts, reduce costs associated with such transfers, and improve the privacy and security of participant data.
- Encourage a future Council to consider the issues related to standardized technology solutions for automatic account aggregation for job changers.

## Pharmacy Benefit Manager (PBM) Compensation and Fee Disclosure

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- Mark E. Schmidtke, Issue Vice Chair
- Christine Hwang, Drafting Team Member
- Dennis Mahoney, Drafting Team Member

## PBM Compensation and Fee Disclosure

### Our Goal:

- Investigate and recommend whether DOL's existing Regulations under ERISA §408(b)(2) requiring that pension plan service providers disclose direct and indirect compensation to pension plan sponsors be extended to include PBM service providers to ERISA-covered group health plans.

## PBM Compensation and Fee Disclosure

### 408(b)(2) Department Regulations:

- 29 C.F.R. §2560.408b-2(c)(1)(viii)(B)(3):
  - Requires disclosure of a description of direct and indirect compensation.
  - Expressed as a monetary amount, **formula**, percentage of the covered plan's assets, or per capita charge, or **other reasonable method** when compensation cannot reasonably be expressed in such terms.
  - May include reasonable and good faith estimate where provider cannot reasonably describe compensation or cost and explains methodology and assumptions to prepare such estimate.

## PBM Compensation and Fee Disclosure

### 2013 Schedule C Instructions, Form 5500:

- For indirect compensation, must disclose:
  - (a) the existence of the indirect compensation;
  - (b) the services provided for the indirect compensation or the purpose for payment of the indirect compensation;
  - (c) the amount (or estimate) of the compensation or a **description of the formula** used to calculate or determine the compensation; and
  - (d) the identity of the party or parties paying and receiving the compensation.

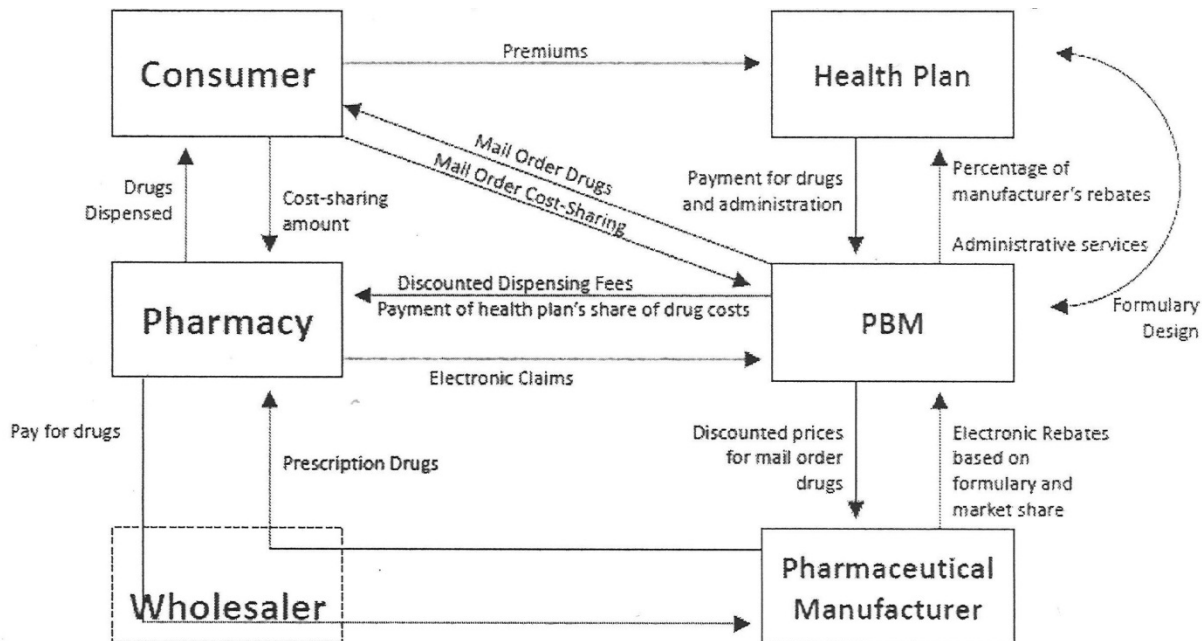
## PBM Compensation and Fee Disclosure

### Model Reporting Form:

Required Information	Location(s)
Description of the services that ABC will provide to your Plan.	Master Service Agreement § 2.4, p. 1
A statement concerning the services that ABC will provide as [an ERISA fiduciary] [a registered investment adviser].	Master Service Agreement § 2.5, p. 2
Compensation ABC will receive from your Plan (“direct” compensation).	Master Service Agreement §3.2, p. 4
Compensation ABC will receive from other parties that are not related to ABC (“indirect” compensation).	Master Service Agreement § 3.3, p. 4 Stable Value Offering Agreement § 3.1, p. 4
Compensation that will be paid among ABC and related parties.	Master Service Agreement § 3.5, p. 6
Compensation ABC will receive if you terminate this service agreement.	Master Service Agreement § 9.2, p. 11
The cost to your Plan of recordkeeping services.	Master Service Agreement §3.4, p. 5

## PBM Compensation and Fee Disclosure

### Flow of Money and Goods: (Presented by Professor Patricia Danzon)



## **PBM Compensation and Fee Disclosure**

### **Findings:**

- Testimony from plan sponsors:
  - PBMs provide valuable services.
  - Drug pricing is complex and evolving and PBMs do not fully disclose PBM compensation.
  - Some forms of PBM compensation have the potential for creating conflicts of interest for PBMs.
  - Disclosure of PBM compensation would better enable plan sponsors to determine if compensation paid for PBM services is reasonable.
  - Voluntary accreditation and certification efforts have thus far not presented plan sponsors with a workable alternative to disclosure.
  - Restrictions on audits of PBM arrangements may present obstacles to plan sponsors who wish to audit a PBM contract.
- There were competing views as to:
  - Current state of competition in the PBM Industry; and
  - Whether mandatory disclosure of PBM compensation under DOL Regulations would adversely impact plans and/or PBMs.
- The PBM Industry expressed concerns about confidentiality and potential for collusion if PBMs are required to disclose compensation, but these concerns appear to be mitigated by:
  - PBMs currently enter into disclosure agreements combined with confidentiality requirements; and
  - 408(b)(2) Regulations allow disclosure of a “formula” or “other reasonable method” of compensation.

## **PBM Compensation and Fee Disclosure**

### **Recommendations:**

- Recommendation No. 1:

DOL should consider making Section 408(b)(2) Regulations applicable to welfare plan arrangements with PBMs, and thereby deem such arrangements reasonable only where PBMs disclose direct and indirect compensation, including compensation paid among related parties such as subcontractors, in a manner consistent with current Section 408(b)(2) Regulations.
- Recommendation No. 2:

DOL should consider issuing guidance to assist plan sponsors in determining whether and how to conduct a PBM audit of direct and indirect compensation.

## **Outsourcing Employee Benefit Plan Services**

- Ralph C. Derbyshire, Issue Chair
- David C. Kaleda, Issue Vice Chair
- Cindy Hounsell, Drafting Team Member
- Deborah L. Smith, Drafting Team Member

## **Outsourcing Employee Benefit Plan Services**

### **Our Goals:**

- Identify industry practices and trends regarding outsourced services, the market for delivery of those services and contracting practices.
- Clarify the legal framework under ERISA for retaining outsourced service providers.
- Identify current best practices in selecting and monitoring outsourced service providers.
- Examine insurance coverage and ERISA bonding practices of outsourced services.

## **Outsourcing Employee Benefit Plan Services**

### **Findings:**

#### **Current Practices in Outsourcing**

- Emerging trends:
  - Outsourcing of functions that have traditionally been exercised by plan sponsors.
  - Increasing interest in OCIO arrangements.
  - Use of MEPs as a mechanism of outsourcing, particularly in the small employer market.
- Confusion over shifting of fiduciary risk through outsourcing arrangements.
- Importance of the contract as the “roadmap” for the complex and customized relationships in outsourcing.



### **Legal Framework for Outsourcing:**

- Lack of understanding of the extent to which fiduciaries remain subject to ERISA fiduciary liability when outsourcing plan responsibilities.
- Key areas to consider include:
  - Responsibility for designating named fiduciaries.
  - Extent of co-fiduciary liability.
  - Difference between fiduciary and ministerial functions.
  - “Delegation” of non-fiduciary functions.

### **Duty to Select and Monitor Service Providers:**

- Need to consolidate and expand guidance on how fiduciaries meet the duty to select and monitor outsourced activities.
- Factors to consider include: (1) financial soundness; (2) expertise; (3) training; (4) business model; (5) registration and licensing, where applicable; and (6) reputation.
- Use of consultants and other professionals to assist in selection and monitoring.
- Need for industry standards and benchmarks.

### **Multiple Employer Plans (MEPs) and Similar Arrangements:**

- Advantages of outsourcing through MEPs and similar arrangements, particularly for small employers.
- Concerns expressed over nexus requirement as it relates to "open MEPs."
- Tension between balancing the benefits of outsourcing against potential downsides for participants is most prevalent in the area of vendor oversight.

### **Bonding and Insurance Practices:**

- There is considerable confusion over both the persons required to be bonded and the specific activities that require bonding.
- In selecting insurance coverage, key considerations include: (1) the insurance carrier; (2) limit of liability; (3) cost; and (4) scope of coverage.
- Assessing the need and cost for insurance coverage is complex.

# Outsourcing Employee Benefit Plan Services

## Recommendations:

### A. Educate plan sponsors on current practices with respect to outsourced services, including:

- Provide industry information about the range of outsourcing options and types of providers, specifically with respect to Outsourced Chief Investment Officer (OCIO) arrangements.
- Provide information on contracting practices such as termination rights, indemnification, liability caps, service level agreements, etc. that might assist plan sponsors and other fiduciaries in negotiating service agreements.

### B. Clarify the legal framework under ERISA for delegating responsibility to service providers in the following respects:

- The plan sponsor's responsibility under ERISA Section 404 where the plan document designates a "named fiduciary" under ERISA Section 402(a) that is not the plan sponsor.
- The scope of liability of a fiduciary who appoints a non-fiduciary service provider to perform functions necessary for the operation and administration of the plan.
- The application of the co-fiduciary provisions of ERISA Section 405 including:
  - (i) whether the co-fiduciary liability provisions of ERISA Section 405(c)(2)(B) impose additional obligations on an appointing fiduciary beyond the duty to select and monitor an appointed fiduciary and, if so, the extent of those duties,
  - (ii) the standard of knowledge required for co-fiduciary liability under ERISA Section 405(a) and
  - (iii) contribution rights among co-fiduciaries.

### C. Provide additional guidance on the duty to select and monitor service providers:

- Consolidate prior guidance on a fiduciary's duty to select and monitor service providers.
- Provide guidance on the frequency and scope of monitoring required.
- Identify "questions to ask" and other best practices in selecting and monitoring service providers.
- Provide guidance on managing potential conflicts of interest in engaging fiduciary service providers.
- Publish clear examination and enforcement priorities and follow up with publication of relevant examination findings.

**D. Facilitate the use of multiple employer plans and similar arrangements as a means of encouraging plan formation, including:**

- Consider the benefits of multiple employer plans and similar arrangements in rulings, regulations and interpretations.
- Consider developing a sample structure for multiple employer plans that will help ensure that conflicts of interest, prohibited transactions, fiduciary independence, and disclosure are addressed.
- Develop rules or safe harbors for multiple employer plan sponsors and adopting employers that would minimize liability from acts of non-compliant adopting employers.

**E. Update and provide additional guidance on insurance coverage and ERISA bonding of outsourced service providers:**

- Clarify and modernize the fidelity bond regulations and Field Assistance Bulletin 2008-04.
- Educate plan sponsors on availability of fiduciary insurance coverage, including information on scope of coverage, deductibles, policy limits, and ratings of insurers.