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401(k) Outsourcing: The Next Big Thing

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Outsourcing is the hiring of a consultant from outside the company to complete a task or provide a service that they are better suited to do then your own employees. Many small to mid sized plans are beginning to outsource 401(k) fiduciaries.

Companies outsource many services, including payroll, auditing, marketing, legal defense, building maintenance, HR services and advertising, to name but a few. The reasons for outsourcing generally include:

1. Cost savings
2. Better outcome
3. Cost savings
4. Increased productivity
5. Allows employees to do the things that they do best

Numerous business experts and consultants tout the benefits of outsourcing. "Do what you do best and outsource the rest," says Tom Peters, management consultant *extraordinaire*. Former HUD Secretary Alphonso Jackson once stated, "When work can be done outside better than it can be done inside, we should do it."

There is now a growing trend to outsource 401(k) services for many of the same reasons, but also because there are additional benefits in so doing, such as:

1. Reduced liability
2. Increased objectivity
3. Fewer conflicts of interest
4. Increased service level

As you ponder outsourcing 401(k) services, understand that there are differing levels of fiduciary protections to consider, from partial responsibility to total responsibility.

1. ERISA Section 3(21) Investment Fiduciary: These advisors assume "co-fiduciary" responsibility, and they accept that responsibility in writing. As a plan advisor, they can offer "objective" advice and recommendations to the business owners or board of directors who may make the actual decision as to selecting, monitoring and removing plan investments. Given the co-fiduciary aspect, the business owner or board of directors are still on the hook for investment responsibility, but at a minimum, they are reasonably assured that the advice they receive from the 3(21) advisor is prudent, objective and independent from other service providers.
2. ERISA Section 3(38) Investment Manager: These advisors also accept fiduciary responsibility, in writing, but they assume *total* responsibility and liability for the selection, monitoring and removal of investment options. Under this type of 401(k) outsourcing, the business owner, board of directors or any other fiduciaries cannot be held legally responsible or liable for investment decisions. The 3(38) advisor acts independently, and is not typically subject to conflicts of interest that might exist with advisors who represent the financial service providers to the plan.
3. ERISA Section 3(16) Fiduciary – This individual accepts total responsibility for the operation of the 401(k) plan, which includes the hiring of service providers, ensuring appropriate and timely filings, handling disclosure notices, etc. The 3(16) Fiduciary operates the plan, rather than the plan committee, business owner or board of directors. The 3(16), appoints a 3(38) Fiduciary to be responsible for the management of the plan's investments. The only responsibility of the business owner or board of directors is to select and monitor the 3(16) Fiduciary.
4. Multiple Employer Plan (MEP) – A MEP is a plan operated by a 3(16) Fiduciary, who appoints a 3(38) Investment Manager, and two or more independent companies to participate in the MEP. An example would be a MEP sponsored by a Chamber of Commerce or a trade association, offering the MEP for the benefit of the member companies. For small companies, the MEP can be a significantly more efficient and cost effective mechanism when providing the benefits of a 401(k).

Part of the reason outsourcing is catching on in the 401(k) area is that ERISA's "prudent expert rule" specifically states that the plan should outsource to independent experts if they themselves do not have the expertise, because it is ultimately in the plan participants' benefit.

Large firms such as Google, Apple, Bank of America, Exxon and Microsoft might feel that they have the expertise on their staff to operate their 401(k) but having outside objective fiduciary guidance would only help as well.
