

PUTTING IT ALL TOGETHER

VENDOR SELECTION



You're finally ready to choose a service provider. But whether you're going to start up a new retirement plan or change one or all of the vendors currently servicing your plan, you'll need more than just information to do it right. There's reams of data out there (not necessarily arranged in a coherent way.) Where do you start? You need a process, a way to sort through what can appear to be an overwhelming number of options.¹

This chapter is about bringing the vendor-selection process together into a logical, cohesive whole. It is the “how-to” chapter, designed as a step-by-step process, to guarantee that you make the right buying decision for your company.

One of the themes stressed throughout this book is that your fiduciary responsibility is intimately linked to procedural due diligence. In the last analysis, you demonstrate diligence through process, not outcome. With 401(k)s increasingly in the headlines, you cannot afford to be careless when selecting service providers or picking investments. There's just too much at stake, both for you and your employees. Following a systematic, rigorous process and documenting each step is necessary for two reasons. First, it will increase the chances of making a correct buying decision. Second, it will ensure

that the actions you take to select a vendor can be defended. Remember, when you are the steward of other people's money, your actions are held to a very high standard. So, let's get started. Your employees are counting on you.

The buying process can be broken down into several discrete steps, each one contributing to the overall integrity of the process. As with any large project involving a lot of information, the key to successful selection and implementation is time. Give yourself enough time to do the job correctly. You don't want to have to repeat this process any time soon if you don't have to. Below you'll find a brief overview of the eleven steps that will help you find the best service provider for your company.

MARKETING PROCESS OVERVIEW

1. Benchmark the Current Plan

If you already have a plan, it's important to know how it stacks up against key benchmarks: compliance, participation, average deferral percentage, asset allocation, investment performance, and plan costs. A thorough understanding of the current plan's strengths and weaknesses will help to determine if "marketing" the plan (i.e., shopping the plan to other service providers) is even necessary. It may be that the plan's weaknesses have more to do with plan design, employee demographics, or lack of company focus than vendor performance.²

If you do decide that vendor performance is part of the problem and that marketing is necessary, a benchmarking analysis will identify plan weaknesses. This will, in turn, become the starting point for setting well-defined goals. You may also wish to survey employees and ask them for their opinions of the plan and what they would like to see improved. Armed with this information, you are now ready to begin the marketing process.

2. Determine the Decision-Making Body

Decide who will be part of the decision-making team. A small committee of

people from different parts of the organization (finance, human resources, operations, management, legal) is usually best. If there are “vocal” employees who have been advocating change, perhaps this is the time to bring them into the process too. By making a group decision, you will ensure support from key personnel—an asset in selling the plan throughout the organization. To avoid any last-minute power struggles, make sure that the committee has final decision-making power. You may also conclude that an internal committee does not have the resources to conduct a thorough search and that you need assistance in specific areas. We now look at the pros and cons of hiring outsiders to assist in the project.

3. Hire an Outsider

Does it make sense to hire a third-party to assist with the vendor selection process, new plan installation, and/or investment monitoring process? You may decide that, collectively, your company doesn't have the time or expertise to perform these tasks by itself. More and more small and mid-size companies are following the lead of large companies and hiring consultants to assist them in the search process. Small companies have always relied on outside help, usually through accountants, insurance agents, and general benefit brokers. Specialized experts (whether they are brokers or consultants) can provide invaluable assistance by bringing speed, objectivity, organizational efficiency, and negotiating power to the process. But hiring an outsider does not necessarily guarantee a good buying decision. Here are some key questions to ask:

♦ *What are the broker's/consultant's qualifications?*

Is he a pension expert or a benefit generalist? How many vendor searches has he conducted? Who are his clients? Can you talk to them? Does he understand investments, recordkeeping, compliance, employee education and communication? Insist on seeing work samples. Does the broker/consultant follow a systematic and thorough process? Can he do everything you want done? Will you receive written documentation highlighting the

main facts of the evaluation and selection process? Is the broker/consultant objective? Does he have any formal marketing relationships that may influence his recommendation? How quickly can he complete the project? Does he have support staff to help? Who will negotiate performance and service standards: you or the broker/consultant?

♦ *How does the broker/consultant get paid: fee or commission?*

If you are a start-up or “small” plan (generally speaking, under \$25 million in total plan assets), there are many good bundled 401(k) products that have commissions built into them and are designed to be distributed by “brokers,” i.e., third-party intermediaries who are remunerated for their services. To complicate matters, there are other good products that do not have commissions built into them. If you do use a broker, do not expect him to bring a noncommissioned product to you. If you prefer to use a consultant and pay a fee instead, insist on a “scope of services” agreement detailing exactly what the consultant will do and how and when he will be paid. To protect the integrity of the process and to avoid any conflicts of interest, you need to know in advance exactly how the third-party gets paid.

4. Set Plan Objectives and Goals

It is important to understand what you want to achieve prior to starting. Setting goals dictates the nature of the search and simplifies it immensely. Setting goals first, rather than relying on the search process to define them, will dramatically improve the speed and quality of the vendor search process. If you already have a plan, benchmark it! If no plan currently exists, write down overall objectives based on the data in this book. By clarifying plan objectives in advance, you automatically narrow the dizzying array of potential service providers to a manageable number, say, five to ten, and greatly simplify the search process.

5. Select Markets

The next step is to “pick markets” (i.e., decide from which service providers you would like to get a proposal.) Ask companies similar to yours whom they use and why they like or dislike the vendor. Consult media sources (See the appendix). *CFO* and *Plan Sponsor Magazine* print annual 401(k) “buying guides.” I usually try to select at least one provider from each of the main vendor types—bank, insurance company, brokerage firm, and mutual fund company—for comparison purposes. Depending on overall goals, plan design complexity, asset size, employee demographics, geographic location, and company culture, you will naturally gravitate toward certain types of service provider configurations (e.g., bundled, alliance, unbundled, etc.) and certain types of vendors (e.g., mutual fund, bank, insurance company, etc.) For example, a five-hundred-employee white-collar company spread out in several locations across the country with \$15 million in plan assets and a straightforward plan design may end up looking at more bundled, mutual fund–based products.

6. Draft an Investment Policy Statement (IPS)

If you don’t already have one, drafting an IPS will also simplify the search process. Even if you only decide on core asset classes, the total number of funds, and the number of funds in each class, these steps will go a long way toward allowing comparisons across different service providers’ investment universes. Once you pick your service provider, a well-designed IPS will also prevent you from becoming overwhelmed by the investment selection process. (For more information about IPS, see chapter 9, “Investments,” and the appendix.)

7. Send out a Request for Proposal (RFP)

A well-written RFP is the backbone of a good search. Without one, it is difficult to conduct a diligent search. An RFP also saves time by allowing you to ask core capability questions in a structured format and to

cross-reference answers from a broad spectrum of good-fit service providers. A good RFP should contain all of the following sections:

♦ *Plan information*

Basic plan information, such as assets broken down by investment option, eligible and participating employees, locations, net annual cash flow, payroll, plan design, etc. Service providers need all relevant information about your plan so they can respond in detail. Withholding key information from service providers during the marketing process is counterproductive.

♦ *Goals and search objectives*

Tell the potential service providers exactly what you are trying to accomplish. By letting them know your goals early on in the RFP stage, you will help them to address your needs better.

♦ *Detailed questionnaire*

All key areas, such as provider overview, compliance, record-keeping and administration, investments, employee education materials, implementation schedule, and fees, should be addressed.

If you are in a hurry, there are several high-quality Web sites where you can both shop for a plan and indeed, buy one. If you are setting up a plan for the first time, the shopping sites allow for easy vendor comparisons. They can take the place of an RFP, since few service providers will respond to a full-blown RFP request from a start-up plan. If you already have a plan, these sites can be a useful way to quickly gather good information about service providers, but they lack the detailed responses and customized nature of a properly completed RFP response. See the appendix for more information about RFPs and web-based shopping sites.

8. Analyze Vendor Responses

Now that you have collected all the data, it's time to analyze it. There are many criteria by which to evaluate service providers: record-keeping/

administration, investments, education, costs, compliance services and market share, to name just a few. Some things, like recordkeeping functionality, technological features, investment performance, and plan costs, are quantifiable and lend themselves readily to spreadsheet analysis. (We discussed these areas in detail in chapters 9, 10, and 12.) Others, like the quality of employee education materials and commitment to service, are more subjective. This is where a well-designed RFP is invaluable, since it will give you a good idea of a vendor's true strengths and weaknesses. For example, the ability of the vendor to meet your company's needs in areas like outsourcing, merger and acquisition services, and ongoing education and communication are often critical to the success of a plan and should be factored into the capabilities of a 401(k) provider. Depending on your search objectives, you may wish to weight certain areas more than others and rank the vendors by a point system.

9. Select Finalists and Interview

The reason for the analysis is to select the best vendor for your needs. Once you make your preliminary selections, you will want to contact the finalists and ask them to come in for a brief, well-structured interview. (As a courtesy, you should notify the RFP respondents who did not make the final cut of your decision as quickly as possible.) Because salespeople can be long-winded, for the sake of efficiency, it is a good idea to establish the parameters of the meeting in advance. Prior to the interviews, I send an agenda to the finalists so that they come prepared. A typical agenda includes the following information:

- ◆ Meeting dates and time allowed
- ◆ Names and titles of people in attendance
- ◆ Restatement of plan search and objectives
- ◆ Suggested outline of the meeting: recordkeeping and administration, investments, employee education, costs and fees, conversion process, etc.

The point of the meeting is to have the company representative paint

a detailed picture of how their systems work, how they would help your plan meet its overall goals, and to review important information about fees, timelines, responsibilities, etc.

By analyzing the finalists' RFP responses and conducting a cost- and hypothetical-investment analysis in advance,³ you can keep the meetings brief and to the point. The agenda will also keep everyone on track. If appropriate, you may also request that finalists bring the actual people with whom you will be working during the transition and on a day-to-day basis once the plan is firmly established. That way, you can meet the vendor's service team in advance, to determine if there are any compatibility issues.

Finally, if time and budget permit, try to visit the recordkeeping facility of your top one or two finalists to meet the people who will administer your plan back at the "home office." There is nothing quite like taking a behind-the-scenes tour of a service provider's administrative shop. This is also a good time to "kick" the technology tires of the finalists. Visiting the call center, seeing the technology that supports the plan in action, and meeting the people who are responsible for administering your plan, is highly recommended.

10. Check References and Read Service Agreements

After you have conducted in-person interviews and on site meetings, call the references you requested in the RFP. Asking a combination of specific and open-ended questions will get you better responses. Try to contact at least one client that has recently left the vendor. Recently terminated clients often have a different perspective than current ones.

Now is also the time to request a plan service agreement so you can see what services are included and which are guaranteed. At a minimum, it should include responsibility for payroll data, participant statements and sponsor reports, all required discrimination testing and preparation of SPDs and a signature-ready 5500.

11. Select Vendor and Negotiate Contracts

You're almost finished. It's time to pick the vendor. Now is your best

chance of securing the most favorable pricing. As in most business ventures, the more money you bring to the table (both in gross dollars as well as average account balances), the greater your ability to negotiate a better deal. Things you might want to consider requesting:

- ◆ Waiver of setup and/or conversion costs
- ◆ Increased use of nonproprietary or “outside” funds
- ◆ Reduction in annual explicit fees
- ◆ Reduction in asset-based “wrap” fees, if applicable
- ◆ Use of institutionally priced investment options
- ◆ More employee enrollment meetings, both first year and subsequent years
- ◆ Performance guarantees with some of the vendor’s fees “at risk”
- ◆ Vendor commitment to overall plan goals, such as participation, savings rates, and asset allocation

MARKETING SUMMARY

To do a good job, to be procedurally diligent, you are required to take the majority of the above steps. As you review the process, consider whether you and your company have the staff, the time, and the expertise to take these steps by yourselves. If not, consider hiring a qualified professional to assist in some or all of the steps. And remember, give yourself enough time. In the case of start-up plans, that means one to three months. In the case of existing plans, the time needed to conduct a due diligent market search and to transition the plan usually is four to eight months.

TRANSFERRING ASSETS AND RECORDS: WAYS TO MINIMIZE THE “BLACKOUT” PERIOD

If you already have a plan set up, moving a plan from one service provider to another can be a time-consuming and exasperating experience. There are simple ways to minimize the inevitable headaches.

Transferring records and assets involves dealing with four main issues:

1. The correct valuation of the assets maintained by the old recordkeeper and trustee
2. The correct transfer of participant account information from the old to the new recordkeeper
3. The establishment of participant account information by the new recordkeeper
4. The communication of the entire process to the employees

Once a plan has decided to change providers, it must stop remitting contributions to the old provider at a certain point and start sending them to the new provider. At the same time, the old recordkeeper (who has just been fired) has to properly “value” all of the participant balances as of the transfer date of the assets. During this time, participants have no access either to information about their accounts or to the money in their accounts. This is the infamous “blackout,” “lockdown,” or “quiet” period. Once the plan balances are finally valued by the old provider, the new recordkeeper who has been preparing to receive the transfer information accepts and reconciles the account balances with the transferred amounts. The new recordkeeper then sends an account statement to each of the participants confirming the correct transfer amount. The amount of data to be transferred and the quality of the records determines how quickly this process can be completed. Generally speaking, the cleaner the data the easier the transfer. There are some vendors who, with quality data and enough time, can execute a seamless conversion and eliminate the blackout period entirely.

SIMPLIFYING THE TRANSFER PROCESS

There are steps you can take prior to transferring records to assist the process. First, you may use the occasion to legally pay out any terminated employees who have an account balance of less than \$5,000. Not only will this simplify the transfer, you might also save some money if

you are being charged recordkeeping fees for inactive plan participants. Next, clean up any outstanding recordkeeping issues prior to the transfer so that you only move clean data and records. Finally, communicate the entire process to the employees in advance of the conversion. Timely information is the linchpin of a successful conversion. Give participants ample warning of deadlines for moving money between investment options and taking loans and hardship withdrawals. Finally, show them the new fund options and where the old funds will be going.

Once you've successfully implemented your start-up or transitioned your existing plan, it's time to review. Did the plan reach its goals? Plans are not static, and an ongoing review procedure will ensure that the plan stays on track. Review investment performance at least annually. Also, review the critical success measures of the plan at the same time (e.g., compliance, participation, average deferral percentage, asset allocation, etc.) and make changes as necessary.

COMMON MISTAKES IN THE VENDOR SELECTION PROCESS

◆ *Not being procedurally diligent in the search process*

Many sponsors relegate the provider decision to the last minute, don't evaluate investment options, and don't understand costs well enough to make a good, long-term buying decision. This is bad both for the participants and for the company, since it represents a wasted opportunity to provide a top-notch benefit.

◆ *Attempting a market search without the requisite time, personnel or expertise*

You're swamped. It's mid-October. Your assistant is away on an extended leave. You can barely get your own work done when your boss says, "Let's look into starting a 401(k) plan this January." You have no idea where to start or what to look for. You read this book and become concerned about the ramifica-

tions of not making a good buying decision. Part of the answer is to involve colleagues from other parts of the company, such as finance, human resources, and operations, as well as highly motivated or interested employees. Another part of the answer may also involve hiring a third-party broker or consultant to assist.

♦ *Allowing the retirement plan decision-making process to be hijacked by politics and personal relationships*

If there is one company buying decision that should be separated from company politics or other business relationships, it's this one. Evaluate service providers strictly on their ability to meet your employees' retirement needs. Don't select a plan just because your good friend or brother-in-law, who is a part-time insurance agent, has one to sell. This is a bad decision and one that could have lasting legal and financial repercussions.

♦ *Not asking a third-party broker or consultant enough tough questions*

You decide to ask for help in the buying process and turn to the company president's stockbroker or the health insurance agent for assistance. Both of them dabble in the qualified plan business yet neither has actually ever set up a plan or successfully transitioned one. There is no agreement on the services they will perform nor any discussion on how they will be paid.

♦ *Not shopping around*

As in any marketplace, it pays to shop around. Especially since you are buying a product that will support your employees throughout their retirement. That is a serious fiduciary obligation. Different providers with similar service offerings may charge radically different fees.

♦ *Confusing salespeople with consultants and brokers*

Most 401(k) service providers distribute their product through an in-house sales force, and these salespeople are often quite good at

their job, which is selling product. Be careful of relying on them too much for objective information. They may not know the state of the marketplace or other, better alternatives. In addition, they may not be qualified to help you select investments and draft a written investment policy statement.

♦ *Reducing the buying decision to only cost*

Cost is an important part of the 401(k) buying decision, but it is not the only one. Costs need to be placed in a context of the type and quality of the overall services received. And investment-related charges need to be placed into a context of risk-adjusted returns over an extended market period. To base the selection decision simply on who has the lowest cost is a short-sighted solution with long-lasting repercussions.

In the end, it all comes down to this: a good process leads to a good result. There is no silver bullet, no single plan design or service provider that is right for every company or even most companies.

I've worked for over ten years in the field, but my consulting practice still relies on the system laid out in this book for selecting and maintaining a retirement plan. Smart choices don't just happen—there are no shortcuts. All the elements—benchmarking, the request for proposal, plan design and investment analysis, employee education and a regular, on-going system for plan evaluation—are vital.

I've put a lot of emphasis on fiduciary responsibility. Documenting your work will leave a clear paper trail and serve as proof that you executed your fiduciary duties with care and diligence. And if you're in over your head, get professional help. But evaluate your advisors carefully—your fiduciary responsibility extends even to your choice of help.

For better or worse, most Americans must now take an active role in planning for their own financially secure retirement. And plan sponsors play a key role in making that goal of security a reality. The last, best thought I can leave you with is also an excellent departure point for any retirement plan search: Your employees are counting on you. Keep that thought front and center. It's the best compass for your trip.

Notes

1. “There are more than 8,000 mutual funds available today (more than the number of publicly traded businesses) and perhaps as many as 200 vendor/product platforms (a platform is a bundled or integrated service encompassing administration, employee communications and education, and investment management) competing in the market for your attention and, ultimately, your business. Add in another 3,000 firms wanting to manage your assets and a host of recordkeepers, administrators, consultants and advisors, and you have the dizzying mix of configurations and approaches confronting today’s plan sponsor community.” “Revenue Sharing Aspects of Qualified Retirement Plan Management,” Daniel Clark, *Solutions*, September 1998, p. 35.
2. This view is corroborated by the Department of Labor’s ERISA Advisory Council in their “Report of the Working Group on Guidance in Selecting and Monitoring Service Providers” where they write:

“Many of the problems with respect to service providers arise because the responsible fiduciary either does not understand his role and responsibility in the selection and monitoring of service providers or exercises poor judgement because he does not have experience or an appropriate source of information concerning legal requirements and industry practices.”

“Selecting Vendors for Your Defined Contribution Plan,” Schultz, Collins, Lawso, Chambers, Inc.
3. A hypothetical investment portfolio represents a way in which to assess the overall quality of a particular service provider’s investment universe. Using core asset classes such as international equity, large, mid, small cap equity and fixed income, and taking into consideration any restrictions on the ratio of proprietary to nonproprietary funds, one can glean certain insights based on the aggregate portfolio as opposed to looking at funds individually. For example, a well-constructed hypothetical investment portfolio will tell you the average cost of the lineup and also how it has performed as a whole over time. It takes attention away from the performance of a particular fund and instead gives a truer indication of the quality of a service provider’s investment universe.