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10 Questions to Ask Before Signing That New Service Agreement

"Attached is Our Standard Service Agreement…"

Sound familiar? Employers and others (referred to in this article simply as "Employer") who outsource services for their employer benefit plans to vendors, such as record keepers, third party administrators, custodians, and investment advisors, should be wary of so-called "standard" vendor service agreements. We work with many of our clients in reviewing and negotiating proposed service agreements, and in our experience, a vendor's "standard" agreement has generally been designed by its attorneys to protect the vendor. Employers need to carefully review and negotiate proposed service agreement terms (even if their plans are not covered by ERISA) to ensure that they are balanced, fair and reasonable, comply with ERISA where applicable and other applicable law and do not create liabilities, duties and obligations that they, in hindsight, never would have "bargained for." Below are just a few of the most common areas that should be scrutinized and negotiated with the help of business and legal advisors.

1. Who is signing the agreement?

Many "standard" service agreements name the "plan sponsor" as the contracting party, but in fact, the plan sponsor may not be the proper signatory to all or part of the agreement. An Employer must look at its plan document and other relevant documents, such as any committee charter, to determine who has the authority to sign a service agreement and who has the obligation to perform under the agreement. That authority may have been delegated (to limit the plan sponsor's fiduciary liability exposure or otherwise) to the plan administrator (which might also be the employer but in a different capacity), plan administrative committee, plan trustee or other person or entity. (See our FAQ on committee charters which can be found here: http://www.boutwellfay.com/wp-content/uploads/2016/09/FAQ-What-is-a-Plan-Committee- Charter.pdf). In short, the plan sponsor may have purposely relieved itself of the legal authority to engage vendors, and if it just goes along with the "standard" proposal, it may be creating an inconsistency with the plan document and/or create a risk that it is agreeing to take on fiduciary and other duties/liabilities it intended to avoid.

2. Who is a fiduciary with respect to the services covered by the service agreement?

Many "standard" service agreements that we have seen in the past require the Employer to agree that the vendor is not a fiduciary even though some of the vendor's actual responsibilities under the agreement appear to be fiduciary in nature or in fact (for example, determining benefits, administering claims procedures etc.) If the vendor in fact performs fiduciary functions, the Employer should address this with the vendor and review the scope of indemnity provided by the vendor with respect to these functions.

3. How and what exactly is the vendor being paid for its services?

Many "standard" service agreements generally refer to or incorporate a "standard" schedule of fees but provide few (or no) details about the compensation the vendor receives. Without that detail, an Employer may not be able to determine if it is entering into a service agreement that violates ERISA's prohibited transaction rules. (*See* ERISA § 406(a)(1)(C) providing that a service agreement that permits a vendor to receive more than reasonable compensation is a prohibited transaction). (See also DOL's §408(b)(2) disclosure rules that require plan fiduciaries to understand and take into account all indirect and other compensation paid to vendors to determine if compensation is reasonable.) (*See* 29 C.F.R. § 2550.408b-2.) The service agreement needs to clearly set out exactly what compensation (direct and indirect) is to be paid to the vendor (or how that compensation will be determined). This is one area in which you may see big changes as vendors react to the new fiduciary rule.

4. What services is the vendor agreeing to provide to the plan?

Many "standard" service agreements use vague or general language about the nature of the vendor's services (for example "provide record keeping and reporting services"), and/or reference non-contractual/internal and non-client specific schedules for a description of services. The service agreement should clearly spell out the services being provided.

5. What obligations is the Employer undertaking under the service agreement?

Many "standard" service agreements give the vendor unilateral discretion to dictate at a future time or in some non-contractual document what the Employer must do to enable the vendor to perform its services. For example, many service agreements provide that the vendor will unilaterally determine what information/data the Employer must provide and how and when the information/data must be provided. They also often provide that the vendor has the absolute right to rely on information/data received from the Employer and/or others, with no vendor obligation to verify or even question the correctness of

information it receives (even when it suspects it is wrong!) The service agreement should spell out each party's obligations with sufficient clarity that each party understands its obligations under the agreement.

6. Who is responsible for the vendor's mistakes – limits of liability, indemnity and hold harmless provisions?

Many "standard" service agreements contain strong unilateral indemnity provisions and/or liability caps/hold harmless provisions whereby the Employer agrees to indemnify the vendor for all losses that the vendor causes whether the vendor's conduct is inadvertent, negligent or intentional. Similarly, many service agreements cap vendor liability at a set dollar amount – often the amount of fees the Employer pays to the vendor regardless of the actual amount of loss the vendor causes. Moreover, some "standard" service agreements do not contain reciprocal indemnity where the vendor is liable for losses it causes to the plan, plan sponsor/participants, or, if they do contain reciprocal provisions, they are effectively negated by a hold harmless or liability cap protecting it. All of these types of clauses should be reviewed by counsel and thoughtfully negotiated.

7. What is the vendor doing to protect plan/participants' data?

Many "standard" service provisions have a so-called "force majeure provision" that protects the vendor from liability in the event of a disaster or other so-called "act of God." Typically, these provisions include data breaches and internet failures. However, vendors should have in place a disaster recovery plan and Employers will want to carefully review these provisions in the agreement and take other appropriate steps to protect the Employer/participants from losses/damages caused by a vendor security breach.

8. Can the vendor change things mid-contract?

Many "standard" service contracts provide that the vendor at any time has the right to amend the service agreement, including provisions relating to its own fees, but that the Employer has no reciprocal right. Amendments should be by agreement only and in writing and/or, at the very least, upon advance adequate notice with an unequivocal right of the Employer to reject any proposed amendment.

9. How is the service agreement terminated?

Many "standard" service agreements permit the vendor to terminate the agreement virtually without notice in the event of non-payment of fees (and for certain other reasons) and/or in the normal course of business without sufficient notice to allow the Employer to replace the vendor. The DOL's § 408(b)(2)

regulations require, however, that the agreement must permit termination without penalty so that the plan does not get "locked into an arrangement that has become disadvantageous." Thus, the termination provisions of a service agreement should be negotiated to provide sufficient bilateral notice of termination and they should also expressly provide a detailed transition plan to support a move to a new vendor.

10. What happens to the plan records?

Any service agreement should specifically address how records will be maintained, how they will be made available, who owns them and what will happen to them after the applicable retention period. See http://www.boutwellfay.com/wp-content/uploads/2016/07/FAQ-Re-ERISAs-Records-Retention-for-EB-Plans.pdf.

Conclusion:

As can be seen from this brief sampling of service agreement issues, just signing off on a "standard" service agreement can create significant risks. Employers and others (such as in-house counsel) who are asked to review and/or sign service agreements for employee benefit plans will want to review the provisions of these contacts carefully.