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Health and Welfare Plan Administrative Services Agreements: Negotiating, Drafting, and Monitoring Agreements

Guidance for Counsel to Employers and Third-Party Service Providers

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Health and Welfare Plan Administrative Services Agreements: Negotiating, Drafting and Monitoring Agreements

May 13, 2020

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Background Principles – Prudence Standard for Plan Fiduciaries

ERISA § 404(a)

- Proceeding with the “care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims”
 - Selection and monitoring of service providers
- Some refer to a “prudent expert” standard and to “procedural prudence”
- Generally leaving us with - deference to nonconflicted, expert, educated fiduciary decision-making that takes into account all relevant considerations

Background Principles – Prudence Standard (cont'd)

- DOL Advisory Opinion 2003-02A
 - Discussion of fees in light of industry standards
- DOL Report of the Working Group on Guidance in Selecting and Monitoring of Service Providers
 - Focus on documentation of the process

Background Principles – Prohibited Transactions

ERISA §§ 406(a)(1)(C), 408(b)(2)

- Unless an exemption applies, a plan fiduciary “shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect ... furnishing of goods ... services ... between the plan and a party in interest”
- Exemption for “[c]ontracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor”
 - “Reasonable compensation” for “necessary services”
 - Terminability
- Other possible exemptions
 - QPAM
 - INHAM
 - Others?

Background Principles – Prohibited Transactions (cont'd)

- Is an exemption always necessary?
 - *Brock v. Gerace, 7 Empl. Benefits Cas. (BNA) 1713, 1715 (D.N.J. Apr. 17, 1986)* (“[T]he government’s position is that the plan’s initial agreement with a service provider creates the ‘party-in-interest’ status and that any subsequent agreements between the plan and these parties, even routine renewals of existing agreements, fall within the reach of Section 406(a)”)
 - *UFCW Local 56 Health & Welfare Fund v. Brandywine Operating P’ship, 36 Empl. Benefits Cas. (BNA) 1400, 1403 (D.N.J. Oct. 28, 2005)* (“To be a ‘person providing services’ under Section [3](14)(B), a party must have a relationship with the pension plan that preexists, or is independent of, the relationship created by the allegedly prohibited transaction.”)
- Arguably, regardless of possible arguments that no exemption is necessary in some cases, the market generally looks for the 408(b)(2) exemption or another exemption
- Self-dealing prohibited transactions (ERISA § 406(b))

Health and Welfare Plan Services

- How does plan funding impact the services that are needed and the level of responsibility? (self-funded vs fully insured benefit options)
- Are you working with a broker?
- Types of Services that may require Third Party Administrative Services Agreements:
 - Group Health Plans and Healthcare FSAs
 - What benefit options are covered under the agreement?
 - COBRA Administration
 - Stop-loss Coverage
 - Shared Responsibility Reporting (Forms 1094-C and 1095-C reporting)
 - Wellness Programs
 - Retiree Medical Private Exchange Services

The Process – Getting to a Negotiated Agreement

- Preliminary Stage
 - Determine which party at plan sponsor is the contracting fiduciary
 - Define services and search parameters
 - Due diligence
- The Hiring Stage – Request for proposal
 - Analyze and compare competing proposals
 - Select and notify vendor
- The Negotiating Stage
 - Negotiate terms and conditions
 - Draft/revise governing documents

The Hiring Stage – The Request for Proposal

- Determine the deadline date for an executed agreement
- Plan for several phases
 - search
 - evaluation
 - interview
 - negotiation
- Outsource RFP process?
- Consider asking specific questions about how the provider would handle issues unique to plan sponsor
- Document each phase of the plan's RFP process in writing
- Ensure that issues identified in RFP are addressed in TPA contract

The Negotiating Stage – Overview

- What services will TPA provide?
 - How to describe services in agreement
- Disclosure requirements and responsibilities
- Plan sponsor “must-haves” and typical responses by TPAs
- Certain operational issues
- Certain terms of the agreement
 - Who owns what; IP rights; data security
- Financial arrangements
- Indemnification and related issues
- Termination responsibilities
- Certain Other issues – governing law, audits, etc.

The Negotiating Stage – What Services Will TPA provide?

- Plan sponsor may attempt expressly to clarify TPA’s duties with respect to:
 - Who is responsible for Plan documentation, amendments, SPDs and annual notices
 - Internal and External claim and appeal procedures – who is the Claims and Appeals fiduciary? Who is responsible for contracts with independent review organizations (“IROs”)?
 - Who is responsible for Share Responsibility Requirements/Reporting
 - Nondiscrimination and other “legal” compliance
 - Dealing with employees and beneficiaries
 - Will there be a hotline to assist with claims pre-certifications, in-network and out-of-network benefit questions
 - Dealing with Plan Administrator or staff
- TPA may seek clarification, particularly where responsibilities are shared
- TPA may seek to memorialize all decisions in a separate administration manual or document (Benefits Booklets)

The Negotiating Stage – Services (cont'd)

- Certain Documentation and Related Matters
 - Plan documentation and SPDs
 - Open Enrollment materials and Notice requirements
 - Summary of Benefits and Coverage (SBC's)
 - Notice of Privacy Practices
 - Annual Notice Requirements
 - Cost of designing, printing and distributing materials
 - Electronic communications
 - Website
 - Business Associate Agreements

The Negotiating Stage – Services (cont'd)

- Other Services
 - Form 5500 Annual Reports
 - Summary Annual Reports
 - Reporting to plan sponsor
 - Nondiscrimination testing
 - Shared Responsibility Determinations (Safe Harbor Measurement Methods)
 - Forms 1094-C and 1095-C Reporting
 - External Claims Review by Independent Review Organization (IROs)

The Negotiating Stage – Key “Asks” from Plan Sponsors

- Plan sponsor may attempt to require TPA to:
 - Make good-faith compliance efforts
 - Recognize if the Plan is covered by ERISA
 - Accept fiduciary responsibilities for claims and appeals determinations to limit exposure to protected health information of group health plan participants
 - Accept the plan administrator’s interpretations of the Plan document if the TPA disclaims fiduciary responsibility
 - Agree to express contractual limitations on the ability to rely on third-party services and information
- TPA Response?

The Negotiating Stage – Certain Operational Issues

Plan Sponsor Obligations

- Duty to provide timely, accurate information to TPA
- Eligibility determinations
- Authorized points of contact with TPA
- Direction to TPA
- Duty to provide plan documents and amendments

The Negotiating Stage – Certain Terms of the Agreement

- Deadlines for services/implementation
- Work product/IP rights – who “owns” what?
- Source, timing and amount of payments owed
- Cure period
- Consequences of nonpayment
- Confidentiality and information privacy

The Negotiating Stage – Indemnification and Related Issues

- Background legal concepts
 - Exculpatory clauses for “fiduciaries” are prohibited/void against public policy
 - Is the service provider a fiduciary?
 - Indemnification from third parties (including the plan sponsor) and insurance generally permitted
- Will/should indemnification be bilateral?
- Plan sponsor may attempt to provide indemnification only if the TPA exercises good faith and acts without negligence under the terms of the Agreement; TPA may seek broader indemnification
- TPA may seek indemnification from employer for suits by third parties (e.g., participants)

The Negotiating Stage – Indemnification and Related Issues (cont'd)

- Allocation of organization of defense and attorneys' fees
- Will the TPA have to make the sponsor whole for overpayments?
- Will there be performance guarantees with penalties?
 - How will performance penalties be coordinated with indemnification?
- Will the TPA have limited liability?
 - Caps and other limits (e.g., based on fees)
 - Consequential/indirect damages
- Responsibility for cost of benefits
 - Whose plan is it anyway?
- Different Indemnities may be appropriate for different responsibilities
 - Claims Administration
 - Data Privacy

The Negotiating Stage – Termination Responsibilities

- Evergreen provisions
- Coordination with timing of fee increases
- Requirement for “reasonably short notice” under the circumstances
- Define all terms (for example, material breach)
- Review which parties and what events may trigger termination of the Agreement
- Avoid one-sided termination rights or liabilities

The Negotiating Stage – Termination Responsibilities (cont'd)

- Carefully consider survival provision
- Penalty clause v. recovery of start-up costs
- Post-termination cooperation
- Define and allocate costs of conversion to new service providers, including transition services
- Right to keep archival copies of documents and records

The Negotiating Stage – Certain Other Issues

- Audits, generally
 - Audit of service provider
 - Compliance audits of sponsor/fiduciary
 - Eligibility Audits
- Bonding and insurance
- Subcontractors and affiliates
- Dispute resolution (e.g., arbitration, mediation)
 - Informal dispute resolution before going to arbitration, mediation, litigation?
- Governing law/venue
- Corporate transactions
 - Involving the plan sponsor
 - Involving the TPA



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Appendix A - From “Meeting Your Fiduciary Responsibilities” by the U.S. Department of Labor

Excerpts From “Meeting Your Fiduciary Responsibilities” by the Department of Labor

WHAT IS THE SIGNIFICANCE OF BEING A FIDUCIARY?

....

The duty to act prudently is one of a fiduciary’s central responsibilities under ERISA. It requires expertise in a variety of areas, such as investments. Lacking that expertise, a fiduciary will want to hire someone with that professional knowledge to carry out the investment and other functions. Prudence focuses on the PROCESS [emphasis in original] for making fiduciary decisions. Therefore, it is wise to document decisions and the basis for those decisions. . . .

....

HIRING A SERVICE PROVIDER

Hiring a service provider in and of itself is a fiduciary function. When considering prospective service providers, provide each of them with complete and identical information about the plan and what services you are looking for so that you can make a meaningful comparison.

Some items a fiduciary needs to consider when selecting a service provider include:

- Information about the firm itself: financial condition and experience with retirement plans of similar size and complexity;
- Information about the quality of the firm’s services: the identity, experience, and qualifications of professionals who will be handling the plan’s account; any recent litigation or enforcement action that has been taken against the firm; and the firm’s experience or performance record;

Excerpts From “Meeting Your Fiduciary Responsibilities” by the Department of Labor (cont’d)

HIRING A SERVICE PROVIDER (cont’d)

- A description of business practices: how plan assets will be invested if the firm will manage plan investments or how participant investment directions will be handled; the proposed fee structure; and whether the firm has fiduciary liability insurance.

An employer should document its selection (and monitoring) process, and, when using an internal administrative committee, should educate committee members on their roles and responsibilities.

FEES

Fees are just one of several factors fiduciaries need to consider in deciding on service providers and plan investments. When the fees for services are paid out of plan assets, fiduciaries will want to understand the fees and expenses charged and the services provided. While the law does not specify a permissible level of fees, it does require that fees charged to a plan be "reasonable." . . . [footnote omitted]

. . . .

MONITORING A SERVICE PROVIDER

An employer should establish and follow a formal review process at reasonable intervals to decide if it wants to continue using the current service providers or look for replacements. . . .

Appendix B – Summaries of Certain Relevant Case Law

Case Law - Fiduciary Liability

Mertens v. Hewitt Associates, 508 U.S. 248 (1993) - professional service providers will be liable as fiduciaries to the extent they perform fiduciary functions for ERISA plans

IT Corporation v. General American Life Insurance Co., 107 F.3d 1415 (9th Cir. 1997) - although the service agreement stated that the claims administrator was not a fiduciary, the court examined the claims administrator's actual functions to determine whether fiduciary liability applied

Patelco Credit Union v. Sahni, 262 F.3d 897 (9th Cir. 2001) - TPA of self-funded group health plan's assets acted as a fiduciary because the TPA exercised control over the assets by determining the plan sponsor's monthly contribution amount, paid benefits from a fund under TPA's exclusive control, paid itself agreed-to percentage fee out of the account, and received and deposited proceeds of stop-loss held by plan sponsor

Case Law – No Fiduciary Liability

Harris Trust & Savings Bank v. Provident Life & Accident Insurance Co., 57 F.3d 608 (7th Cir. 1995) - the claims administrator is not a fiduciary when administering plan operations under the direction and control of a plan fiduciary in accordance with an administrative services agreement

Kyle Railways Inc. v. Pacific Administrative Services, 990 F.2d 513 (9th Cir. 1993) - the claims administrator performed ministerial functions only and referred all discretionary questions to the plan sponsor, therefore claims administrator did not function as a fiduciary

Klosterman v. Western General Management, Inc., 32 F.3d 1119 (7th Cir. 1994) - claim administrator was not a plan fiduciary because advice on plan design was not discretionary act, SPD supplied by administrator was subject to plan sponsor approval and modification and claim determination was only a ministerial function