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We Don't Need No Stinkin' Service Agreements!

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Um, yes you do.

While many of us have great relationships with our clients – many may be real life friends and not just business acquaintances – you need to operate your business in a way to maximize its success. There are many reasons why a service provider to a retirement plan should have a good written service agreement. In fact, if you don't have one, you are really flying blind.

Hey, You Were Supposed to Do That!

If you are a service provider to a plan, you are under contract. That contract may be written or oral, but when you were hired, a contract was legally formed. If it was an oral contract, then neither you nor your client is sure of the terms. They may think you are doing many, many things that you think are not in your wheelhouse. If they sue you for nonperformance, the judge and jury are likely to hold you, the professional, liable for not being clearer about the scope of your duties.

A written service agreement, on the other hand, makes it evident what you do and don't do, thereby clearing up any confusion on the client's part.

OK, That's One Reason to Have an Agreement. Are There Other Reasons to Do It??

Absolutely. A written service agreement can benefit you in many ways. Below are some general things that service agreements can do.

1. Limit your exposure to liability

Besides ensuring generally that your client is informed about the service you provide, a written agreement can outline your responsibility for specific tasks. For example, when you take over work for an existing plan, it can clarify what responsibility you have for the accuracy of work done before your

engagement and the cost of any review of prior work you may perform. It can outline that you are allowed to rely on what the client tells you about plan issues without a requirement to look deeper into the data.

Even more importantly, the agreement can talk specifically about services you do not perform. The agreement can clarify whether you are or are not a fiduciary, that you provide investment advice only to the plan and not to the participants, and that you do not offer legal or accounting services.

This has real value. One TPA was sued by participants who said it had become a de facto fiduciary through its actions and owed them a duty of communication regarding plan issues. Besides evaluating the services the TPA actually performed, the court looked to its engagement agreement, which specifically provided that it was not a fiduciary and that it did not communicate with plan



participants. The court found that the TPA was not a fiduciary. Similarly, a TPA we know has been sued in connection with investment-related issues despite the fact that it never provided investment services to a client. Even if you are not a TPA, the point is that the terms of the written service agreement can significantly impact the outcome of such suits.

You may contractually limit your liability in a service contract. Some service providers limit the type of liability, such as the kind of damages for which they can be sued (e.g., no punitive damages, no consequential damages), while others limit the dollar amount that the angry client can recover contractually (e.g., limited to the errors and omissions policy maximum or to X times annual fees charged).

You may control the location and type of action a dissatisfied client can take against you. For example, you can require the client to sue you in the courts closest geographically to you, rather than where they are located. This will reduce your litigation costs, and will also ensure that they cannot “hometown” you with local-business-friendly judges. You can require mediation or arbitration in lieu of a lawsuit. You can also outline a dispute procedure for resolving the problem with your client prior to involving the courts or outside argument solvers.

A service agreement may contain indemnification clauses, under which the client is required to pay for your time if a participant, government agency, or other outside person sues you or wants you to provide information or testimony in relation to a plan issue. Without this protection, if you receive a subpoena for records, you will likely be required to pay the costs of providing those out of your own pocket.

2. Control Client Expectations

It is not unusual for a client's expectations as to your services or their obligations to be out of whack. A properly drafted service agreement will outline your mutual responsibilities, so that clients will know what they need to do and what to expect from you. This tends to lead to happier clients.

Part of these expectations has to do with what you will charge the client. ERISA Section 408(b)(2) and its regulations require disclosure of certain charges from some service providers. However, if you are a nonfiduciary, you are likely subject to Section 408(b)(2) only if you receive revenue sharing or other indirect payments. Nonetheless, clients expect you to charge a certain amount and, when your fees are significantly higher, dissatisfaction ensues. A properly drafted service agreement, with a complete and understandable fee schedule, will set those expectations correctly. Furthermore, it will help you if you need to initiate collection efforts against a nonpaying client.

You will find that many of your “billing problems” are really client expectation problems. Clients think you will be cheaper than you are or do not realize that you will be billing for certain tasks. When client expectations align with reality, the billing problems will generally become more manageable. You will always have a client or two that hits hard times and can't pay; but you will have fewer clients who are failing to pay because they are angry.

3. Intangibles

Having a service agreement also helps reinforce to your client that this relationship is important and that the plan and its management are not throwaways. If you are great at providing service, then it is likely that your client thinks that what you

do is easy. A service agreement can show that what you do is extensive and difficult and the fact that it appears so easy is attributable to your amazing expertise.

You can also find out upfront, to some extent, who is going to be a cooperative client. If a prospective client does not want to enter into a written agreement with you, you have to ask yourself: why not? What is in that agreement that the client doesn't like or will refuse to do? If the agreement cannot be tailored to meet the client's needs and concerns, perhaps you're not the right provider for him or her.

Won't My Clients Be Offended That I'm Insisting That They Sign an Agreement?

Again, ask yourself: why would they? They sign agreements with their lawyers and their CPAs; they sign purchase orders for those that provide them with supplies; they likely have some kind of written agreement with their own clients. What is it about you and your services that are undeserving of a formal contract?

Remember also: business is business, even with friends

If your client perceives that you have cost him thousands or more through your error or omission, he or she may have no choice but to sue you for those damages. How many people do you know that would take a large loss that he or she would perceive was your fault without asking for the money back? Even if it is painful personally, the client may have no choice but to seek legal recourse because he/she cannot afford the loss that was sustained.

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Furthermore, everyone's memory of what was said tends to get a little blurred by subsequent events. If all you have to show regarding the agreement is your best recollection of a five-year-old conversation, chances are that your client's best recollection will be different. That's just life.

We are in a service business.

The exact nature of the service we provide can be a little hard to pin down, and people's expectations of what we do can be very different than reality. You need to protect yourself from misunderstandings or being blamed for things that are not your responsibility by having a written agreement with your clients.

It's just downright risky not to.