

# Bundled Services vs. Unbundled Services

## Evaluating Nonqualified Deferred Compensation (NQDC) Plan Services

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Any plan sponsor with, or currently considering, the implementation of a NQDC plan must ask: Is our company better off with bundled services from a single provider or unbundled services from multiple service providers? For most plan sponsors, finding the answer has involved weighing the factors of cost, convenience, and choice<sup>1</sup>. The problem is that most plan sponsors don't have the information or time to fully evaluate these factors.

### *Evaluating the “Bundled Solution”*

Historically NQDC plan services have been dominated by plan providers who offer a “turnkey” solution that bundles plan design, plan funding, plan administration, record keeping, and trustee services, in one package. Such a solution offers convenience to plan sponsors. The problem with this approach, however, is that the “one size fits all” philosophy may not result in the best outcome for plan sponsors. This includes problems with the needed flexibility for customized plans, and camouflaged pricing with hidden costs.

For example, since most Employee Retirement Income Security Act (ERISA) requirements do not apply to NQDC plans, plan sponsors have total flexibility when designing and structuring their plans; therefore no two plans are exactly alike. This flexibility provides many advantages, but efficient and effective plan administration has been difficult for NQDC plan providers. Most NQDC administration systems were built with 401(k) plan record keeping system technology so many of the unique features that have emerged in NQDC plans are usually manually processed. This can increase the cost of providing service. When bundled providers offer to lower or waive administration fees, they have to somehow offset this cost with other sources of revenue through product sales, usually of Corporate Owned Life Insurance (COLI). In most instances, plan sponsors fail to realize that better pricing can be negotiated on a number of COLI expense components<sup>2</sup>. This practice has created an environment that makes it difficult for plan sponsors to understand the true cost of their NQDC plan services as the nature of bundling involves the offsetting costs from one area by revenues in another area<sup>1</sup>.

There are two sources of payment for NQDC plan services:

- 1) Hard costs – plan sponsor pays for service directly by check

- 2) Soft costs – plan sponsor pays indirectly by informally funding the plan with investment products such as mutual funds and /or corporate owned life insurance

Many plan sponsors fail to recognize the soft costs and sometimes select their NQDC provider based simply on low or no hard costs. There are efficiencies in some bundled plans, especially those offering fairly basic features like a 401(k) mirror NQDC plan. However, the custom nature of NQDC designs has eliminated most of the inherent cost benefits that bundling can offer. In fact, some bundled providers are burdened with internal systems incompatibilities, while the unbundled solution can provide a seamless interface with multiple providers<sup>1</sup>. Before selecting a NQDC provider, the plan sponsor should consider the company's goals with respect to the following costs:

#### **Hard Costs**

- Plan Administration and Record Keeping Costs
- Trustee Services Costs

#### **Soft Costs<sup>2</sup>**

- Economic Cost of Funding Vehicle
- Investment Fund Selection of Funding Vehicle
- Tax Cost of Funding Vehicle
- Liquidity Cost of Funding Vehicle
- Pricing of Funding Vehicle

### ***The “Unbundled Solution”***

Retirement Capital Group's (RCG) consulting approach is to unbundle all components of NQDC plan services so plan sponsors can evaluate and understand the total cost (both hard and soft) of implementing a NQDC plan. Generally, one service provider is not an expert or on the “cutting edge” of every aspect of NQDC plan servicing<sup>1</sup>. One bundled provider might be stronger in their record keeping services while another is stronger in investments and funding options. An unbundled approach brings together firms that concentrate individually on record keeping, investments and funding vehicles, trustee services, etc. The firms seeking business in the unbundled arena include many that are focused on best practices rather than on doing the minimum<sup>1</sup>. For example, in the area of record keeping, where the pace of change is rapid and can be costly to keep up with, many sponsors would agree that there is value in having a firm that is proactive and completely dedicated to its mission<sup>1</sup>. Therefore, an unbundled approach can provide the plan sponsor access to “best in class” service.

This applies to all aspects of sponsoring a plan:

- Plan Design – RCG ensures that each plan is customized to specifically meet the client's objectives. In so doing, RCG is able to truly design a custom plan rather than a plan that has to fit under the systems' limitations of the plan provider.
- Benefit Security & Plan Funding – RCG offers an “open architecture” platform with access to virtually all the investment options available in the industry while providing funding alternatives including COLI and mutual funds. RCG evaluates the pros and cons of each funding alternative, disclosing their associated costs.

- Plan Administration – RCG offers clients an expanded universe of administrative options. First, RCG works with clients to identify the needs and culture of the plan sponsor. RCG asks: “Does the plan sponsor want to outsource administration or keep some of it in-house? Does the plan sponsor want to integrate their 401(k) and NQDC plans on one technology platform?” With the proliferation of nonqualified plans, many fee-for-service Third Party Administrators (TPAs) offer systems that compete in functionality and cost with those offered by bundled providers. These new players in the world of nonqualified plan administration include mutual fund companies, 401(k) administrators, software companies, and payroll administrators, among others. Plan sponsors can choose an administrator that offers the services needed to match their goals. RCG conducts due diligence by visiting the offices and testing the system capabilities of plan administrators. With RCG’s help, a plan sponsor can feel confident that their selected administrator has been comprehensively researched. Several potential advantages can result from using the “right” administrator:
  - Integrated qualified plan and nonqualified benefit statements
  - Single web-access to qualified and nonqualified plans
  - Identify the true cost of administration
  - Control over administration
  - Keep pace with the change and current technology with proactive firms that are dedicated to this mission

In the end, RCG’s unbundled solution allows a plan sponsor to design a custom plan tailored to company objectives, select the best administrator, funding vehicle, and other providers necessary to meet the needs as defined by the sponsor’s unique plan. Any firm that proves unsatisfactory can be replaced independently of the others<sup>1</sup>.

### ***A Combination of the “Bundled” and “Unbundled” Solution***

RCG not only “unbundles” the NQDC plan services to help companies evaluate the cost of each component, but also oversees and monitors each of the firms involved, synchronizing all services to provide the plan sponsor with the convenience similar to a bundled provider’s turnkey solution. After evaluating the associated costs of operating a NQDC plan, RCG can assist the plan sponsor bundle some components of the plan services without hiring a bundled provider. For example, for some companies it can be beneficial to bundle record keeping and trustee services with a trust company or bundle record keeping and funding with a mutual fund company. Together, RCG and the selected providers offer plan sponsors a uniquely flexible NQDC plan solution with the expertise of highly respected providers, each independent of the other.

**RCG’s Role:** As the plan sponsor’s primary contact, RCG focuses on the success of the plan. RCG draws on their expertise in plan design, benefit security, funding, and administration to

create a solution that is tailored to the plan sponsor's objectives. At the same time, RCG ensures that the plan is flexible enough to keep pace with best practices and legislative changes.

**Selected Trustee's Role:** The trustee holds plan assets and independently interprets the rules of the benefit security arrangement. The trustee offers third party fiduciary support upon a change in control.

**Selected TPA's Role:** The selected TPA provides the technology to record keep the plan. RCG's Plan Administration Solutions (PAS) has identified TPAs that utilize web-based administration systems to offer a seamless flow of plan information to both plan sponsor and participants.

Unlike a bundled provider that has one in-house administration system, RCG has access to various TPAs that collectively offer multiple solutions to plan sponsors. For example, RCG is able to integrate a 401(k) plan and a NQDC plan on one platform, integrate administration and trustee services, and integrate nonqualified defined benefit and NQDC plans on one platform. The following are scenarios of actual clients who have benefited from the unbundled approach.

### ***The Payroll Provider***

In one recent case, a client had a 401(k) plan that was ably administered by its payroll provider. It made sense to include this provider in the company's search for a NQDC record keeper, even though their nonqualified plan was smaller than the provider's normal plan size. Through RCG's relationship with the TPA, the plan was accepted and the client was able to negotiate lower fees.

### ***The SAS 70 Problem***

Public companies have discovered many challenges brought about by the requirements of Sarbanes Oxley. In one case, the client's audit firm required a SAS 70 Type II audit of the client's benefit plan providers, including the TPA and COLI carrier. Although their then current TPA and COLI carrier were capable of servicing the plan, they were not SAS 70 compliant. Due to the high cost associated with the compliance process, the providers had no plans to become so. RCG enabled the company to find a SAS 70 compliant TPA and COLI that also brought new plan capabilities to improve the benefits to the participants. Similarly, another client's audit firm required a SAS 70 Type II audit of their service providers. In this case, the COLI carrier was SAS 70 compliant, but the TPA was not. RCG helped the company move the plan administration to a SAS 70 Type II compliant TPA without disrupting the funding (COLI contracts).

### ***The 401(k) Provider***

One company wanted to use their 401(k) provider (a mutual fund company) as their nonqualified plan administrator to integrate the 401(k) and NQDC plans on one web platform. The company expects to be in a net-operating-loss position for the next 3-6 years, therefore decided to informally fund the plan with the same or similar mutual funds as their 401(k) plan, but in the future wanted the flexibility to informally fund their plan with corporate owned life insurance as their financial situation changed. There were two problems:

- The provider did not allow the use of a needed customized plan document; and

- The provider did not administer plans informally funded with COLI.

In this case, RCG was able to negotiate both elements, and created new areas of functionality for the provider in the process. The client achieved their goal of integrating their 401(k) and NQDC plans with one provider, and also have the flexibility to change the NQDC plan funding vehicle in the future.

### ***Inadequate Funding Vehicle***

In another case, the client was pleased with their current TPA who was providing nonqualified plan services, but the informal funding vehicle was providing inadequate financial results and, thus, higher than acceptable costs to the company. RCG worked with the client to evaluate the informal funding alternatives. The client selected COLI. RCG helped select a competitive COLI product, and negotiated favorable pricing with the selected COLI carrier. In addition, RCG helped select a TPA who could match the administrative services the company had been enjoying (in this case, daily asset/liability matching).

### ***A Software Company***

A company was record keeping their fixed interest crediting NQDC plan in-house, using Excel, and the plan was unfunded. As the plan grew, the company wanted to reduce the hours spent calculating benefit statements but continue to control the record-keeping in-house. In addition, the company wanted to offset the emerging plan liability with a funding vehicle crediting interest similar to the rate offered in the plan. To assist with the plan administration, RCG worked with the company to select a software company to license their web-based system. Licensing fees are much lower than fees for full administration so the company was able to keep costs down and significantly reduce the hours spent on administration. Also, RCG worked with the client to select a funding vehicle (COLI product) that offered the highest Fixed Fund crediting rate at that time which was higher than the plan crediting rate.

All of the clients mentioned above currently retain RCG as their consultants to oversee and monitor their NQDC plan to keep pace with best practices in each area of their plan.

### ***Conclusion***

Each plan sponsor's decision of whether to bundle or unbundle their plan services is a difficult one. As we have discussed, bundling services can provide convenience, but also can limit plan flexibility and increase overall costs in some cases. Through its unbundling consulting approach, RCG works with plan sponsors to evaluate the costs of each component and helps bring together the "best in class" providers for each of the components of NQDC plan services. As a rule, it is easier for a plan sponsor to get a clear and accurate picture of the costs of each element in an unbundled service plan since it's much more transparent. When you know what you are paying for record keeping, you are in position to weigh the cost against the quality of service. You also know who is paying for which costs and are not in danger of overlooking hidden costs<sup>1</sup>. For some plan sponsors, the bundled plan services may be the right solution. However, without unbundling each plan component and evaluating the associated costs it may be difficult to get an accurate picture.

## ***References***

- <sup>1</sup>Karablas, V. (2004). Bundled or unbundled? A new look at an old question. *Plan Sponsor*, 3.04.
- <sup>2</sup>MacDonald, W. L. (2005). Funding nonqualified benefit plans: The advantages and disadvantages of insurance. *Journal of Retirement Planning March – April*, 19 – 25.