Tools help fiduciaries evaluate plan fees

By Marcia S. Wagner, Esq.

401(k) and other defined contribution plan sponsors are becoming increasingly aware that they face a daunting challenge under ERISA to address responsibilities in their capacity as an ERISA fiduciary. One increasingly evident responsibility of each employer is to ensure the fees incurred by the plan are reasonable.

We have all heard this, but does the typical employer have the necessary expertise and resources to determine the reasonableness of its plan's fees? For many plan sponsors, the answer to this question is a definitive, "No." There is no question that this poses a serious problem given the ongoing scrutiny of service fees in the 401(k) plan industry by Congress and the U.S. Department of Labor ("DOL"). Add to those concerns the growing number of lawsuits filed against employers on the grounds that plan paid fees are excessive.

As a potential remedy to these issues, a number of service organizations are now offering services that aim to compare the fees paid by individual plans against the fees paid by a representative benchmark group of plans. The scope, cost, and, potentially, the quality of these "benchmarking services" varies considerably. Certain benchmarking services are quite ambitious and attempt to gauge not only plan fees but also the value received by the plan in return, while others strictly assess fees. In addition, the timeliness of data, size of the database, method of data verification, and construction of benchmark groups all may vary from one service provider to another. In this article, we will examine how benchmarking services can be used by plan fiduciaries to meet critical requirements under ERISA, in a manner which ultimately benefits plan participants and minimizes fiduciary liability risk for the employer.

Benchmarking services can help employers meet their obligations under ERISA with respect to plan fees in the following ways:

- Assist the employer in its efforts to identify and calculate all plan fees, including any "hidden" indirect compensation paid by the plan's investments (or investment providers).
- Equip the employer with the ability to use benchmarking services as part of a prudent review process to evaluate and monitor the plan's services and fees on an ongoing basis.
- Provide the employer with the competitive pricing information that a prudent expert might have to help assess the reasonableness of the plan's current service arrangement.

With the consent of the plan sponsor, many providers of benchmarking services will work directly with the plan's recordkeeper to obtain the information necessary to determine the various types of revenue sharing payments flowing from the plan's investments (and/or investment providers) to the plan's service providers. Providers of these types of benchmarking services can greatly simplify the employer's review of plan fees. This revenue sharing data can also be used by the plan sponsor to confirm the direct and indirect compensation information which, beginning with the plan year for 2009, must be reported on the plan's Form 5500 information return annually.[1] This recent change to the Form 5500 is just a part of the DOL's regulatory initiative to improve fee transparency, and any such revenue sharing information will continue to be relevant as the DOL moves to finalize its other related regulations.[2]

The following are the basic issues plan sponsors should be aware of:

1. *Duty to Evaluate Services.* Plan sponsors should engage in an objective process that elicits the information necessary to assess the qualifications of service and investment providers, the quality of the services offered, and the reasonableness of the fees charged in light of the services provided. A provider should never be selected simply because it is the cheapest.
2. *Objectives of Benchmarking.* In meeting their duty to evaluate the services being provided to a plan, plan sponsors will attempt to avoid paying above-average investment management fees or expense ratios unless the investment manager or mutual fund can demonstrate it is delivering above-average investment performance for the plan participants. Benchmarking services can help employers meet their obligations under ERISA with respect to plan fees in the following ways:

    - Assist the employer in its efforts to identify and calculate all plan fees, including any "hidden" indirect compensation paid by the plan's investments (or investment providers).
    - Equip the employer with the ability to use benchmarking services as part of a prudent review process to evaluate and monitor the plan's services and fees on an ongoing basis.
    - Provide the employer with the competitive pricing information that a prudent expert might have to help assess the reasonableness of the plan's current service arrangement.

3. *Guidelines for Selecting Benchmarking Services.* Benchmarking services are offered in many forms. Financial advisors should inform their plan sponsor clients that the decision to engage a benchmarking service provider is itself subject to the same fiduciary standards under ERISA that would apply to selecting service providers for the plan generally. In addition, financial advisors who work with plan sponsors should encourage them to make the following inquiries with respect to

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any prospective provider of benchmarking services:

- What are the qualifications and credentials of the provider? How long and to how many clients has the provider been offering benchmarking services?
- Does the provider offer benchmarking analyses for all of the plan's investment and administrative service fees? To what extent are benchmarking analyses provided separately for each individual fee (as opposed to total fees)?
- Will the provider be able to identify all indirect compensation paid to the plan's service providers from the plan's investments and investment providers? Does the provider consider all indirect compensation paid with respect to the benchmark group of plans?
- How reliable is the provider's data for the benchmark group of plans? Is data obtained directly from the various plans' recordkeepers? Does the data gathering method used by the provider prevent inaccurate data submission? Is stale and outdated data disregarded?
- What is the size and profile of the plans included in the benchmark group? How many plans are included in the benchmark group? Can the benchmark group be customized?
- Does the provider offer any benchmarking analyses with respect to the quality of the investment and administrative services provided to the plan?
- In order to make a direct comparison, the actual fees of the various plans are often converted into a per-participant fee or asset-based fee. Does the provider use both per-participant fees and asset-based fees as baselines for its comparisons? If not, why?
- After the benchmarking analyses are completed, what type of consulting services and support will be available to the plan fiduciary in interpreting such analyses?

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Conclusion: Every plan sponsor in its capacity as an ERISA fiduciary has a duty to ensure the fees incurred by the plan are reasonable.

- With the assistance of a reliable benchmarking service provider and the support of the plan's financial advisor, employers can discharge their fiduciary duties in the same manner as would a prudent expert.
- However, it is important that plan fiduciaries recognize that benchmarking services are a tool to be included as part of a broader, prudent review process.
- Plan benchmarking results need to be evaluated in the proper context and critically examined, and decisions involving the hiring and firing of service providers should be based on all relevant factors, and never based on the benchmarking results alone. ❖

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Notes

1. The GAO in its December 2009 report, *Additional Changes Could Improve Employee Benefit Plan Financial Reporting*, recommended that the DOL further increase its Form 5500 disclosure requirements for indirect compensation and that it should coordinate these requirements with the pending ERISA 408(b)(2) regulations.
2. The DOL proposed new regulations under ERISA Section 408(b)(2) in 2007 which, if adopted, would require the plan's service provider to disclose any indirect compensation and potential conflicts of interest. The DOL also proposed regulations in 2008 which, if adopted, would require plan sponsors to furnish fee information to plan participants.