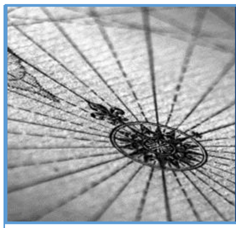

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Fiduciary Considerations for Plan Sponsors - Evaluating Plan Fees

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Key Takeaways

- Plan fiduciaries have a responsibility to ensure that the services provided to their plan are necessary and that cost of those services are reasonable
- Plan fiduciaries can utilize 3 methods outlined within for determining if the fees they paying for plan expenses are reasonable
- Plan fiduciaries will need to recognize any inequities in participant payment of fees

Over the last several years plan sponsors have been bombarded by headlines of class-action lawsuits brought by participants against their companies and many with headline names. Reinforcing plan sponsor concerns are ads placed in newspapers by law firms requesting participants in a particular 401(k) plan call them regarding their "investigation of fees and investment options in their 401(k) plan." Between December 1, 2015 and August 31, 2016, there have been more than 30 new class action lawsuits filed against plan sponsors.[1] Once only thought to target billion dollar plans, two new cases were recently brought against a $9 million and $25 million plans.[2]

The potential consequences for a breach of fiduciary responsibilities can range from personal liability for participant losses and a 20% civil penalty under ERISA Section 502(i). The bottom line is avoiding fiduciary liability requires that a plan committee engage in a prudent and deliberative decision making process and document the process thoroughly - fiduciaries are judged according to the procedural process they undertake.[3] (as opposed to whether they have the lowest cost administrative or investment costs as many are so often led to believe)

Over the last few years, in my experience in working with plan sponsors, I have uncovered 5 major fiduciary issues committees seem to miss in the oversight of their 401(k) plan. These 5 issues, listed below, are the responsibility of plan committee fiduciaries:

1. Fees
2. Investment Policy Development and Menu Oversight
3. Stable Value and Money Market
4. Plan Design
5. Addressing Participant Retirement Readiness

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[1] Cases filed
[2] (Damberg et al v. LaMettry's Collision Inc.), (Bernaola v. Checksmart Financial LLC , S.D. Ohio, No. 2:16-cv-00684, 7/14/16)
[3] "Fiduciary Risk and Liability Management Strategies", Columbia Management Investment Advisers, LLC. 2015.

This series of articles will explain these responsibilities, provide liability reduction strategies, and action steps that plan sponsors can take. Addressing these issues not only provides ways to reduce liabilities, they also meet the Employee Retirement Income Security Act of 1974(ERISA's) main directive to always operate in the best interest of plan participants and their beneficiaries. In essence, they are 5 key ways to improve your plan for the benefit of its participants.

Number One - Fees

A common theme running through class-action lawsuits filed against plan fiduciaries are the violations caused by not properly understanding and addressing the fees of their plan. Experience has shown that plan sponsors have a tendency to go years without fully understanding and prudently evaluating their fees. At the same time, the assets inside the plan will tend to increase in value due to contributions and increases in market value. When fees are left unchecked for an extended period of time and are paid out of plan assets, the participants are the ones that are penalized. How often does a recordkeeper come back to the plan sponsor and alert the fiduciaries that plan is paying more than necessary because assets have increased and that the plan is due for a reduction in fees? Revenue-sharing (by paying all or a portion of plan fees from the plan's underlying mutual fund investments) is a legitimate practice used to pay recordkeeping fees amongst many plans, however it's the fiduciary's responsibility to regularly review these fees and determine whether they are reasonable.

ERISA 408(b)(2) disclosures are the plan fiduciaries window into understanding and gaining insight into their plan fees. Table 1 provides a sample of one of these disclosures. In it, plan sponsors should expect to have their recordkeeper detail what they are collecting in revenue-sharing from the mutual funds for recordkeeping services, advisory services, and any other plan related expenses. Problems and risks begin when plan sponsors are unaware of the total fees their participants are paying.

Table 1 – Sample 408(b)2

Investment option	Current Assets	Revenue Retained by Investment provider	Revenue Sharing to Recordkeeper	Total Investment Expense
Bond Fund R	$2,013,062	0.35%	0.75%	1.07%
Balanced Fund R3	$5,120,110	0.29%	0.65%	0.94%
Equity Fund A	$2,011,202	0.29%	0.79%	1.08%
Total plan	$18,463,000	0.38%	0.68%	1.09%

In a typical ERISA 408(b)2 disclosure, fees are presented in basis points. In the example above, the disclosure shows recordkeeping fees paid are .68% of plan assets. In their bulletin entitled "*Understanding Retirement Plan Fees and Expenses*", the Department of Labor (DOL) specifically states the "Employee Retirement Income Security Act (ERISA), requires that those responsible for managing retirement plans – referred to as fiduciaries - carry out their responsibilities prudently and solely in the interest of the plan's participants and beneficiaries. Among other duties, fiduciaries have a responsibility to ensure that the services provided to their plan are necessary and that cost of those services is reasonable."

The struggle for plan sponsors has always been how to determine if the fees paid to all service providers on the plan are reasonable. In the example above, is 0.68% reasonable? How can a plan fiduciary effectively determine that?

We have effectively utilized three methods with plan sponsors and fiduciaries for determining if plan fees are reasonable. They are as follows:

1. Benchmarking plan expenses
2. Conducting a blind request for information (RFI)
3. Solicit a full scope RFP

Utilizing a Fee Benchmarking Service

A fee benchmarking service is an efficient way to analyze plan fees relative to other plans of similar size in assets and in number of participants. While plan sponsors may have access to a record keeper's reporting of average fees, an independent benchmarking service without affiliations to the recordkeeper, advisers, or other service providers to the plan will provide an unbiased and useful way to compare a plans' fees.

The output provided from this report will give the fiduciary an opportunity to not only evaluate the total fees paid by a plan, but also breakdown a comparison of the most pertinent service providers to the plan, such as the recordkeeping fees, advisory fees, and investment management fees. A benchmarking report was conducted for the sample ERISA 408(b)(2) disclosure listed above. By looking at one of the plan's service providers in greater detail, the report is able to uncover a large discrepancy in what they are being charged relative to a plan of similar size. The results of a comparison of the plans current charges are shown in Figure 1. A case can be made with the recordkeeper to show that the average costs are .37% of assets and their plan is paying .68% of assets for recordkeeping services. In this example, when the recordkeeper was confronted with this information they came back and repriced the plan for the same services and charged only .47%. This is still .1% higher than the average costs paid by other plan sponsors of similar size. While the reduction in fees is welcome, the plan sponsor still has the responsibility to document why the fees are higher by detailing the services that justify the additional expense.

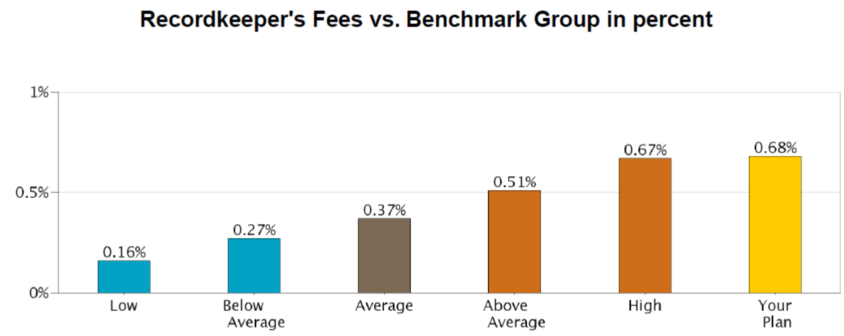

Figure 1 – Sample Benchmark Report

A Blind RFI (Request for Information)

In a plan fiduciary's quest to understand the reasonableness of the fees they are paying for their 401(k) plan, they may simply just need to recognize that the landscape for winning new 401(k) business for recordkeepers has become extremely competitive. In many instances 401(k) providers will aggressively price a plan when competing for new business. A blind RFI *may* provide the leverage needed go back to their existing recordkeeper to lower the fees. Working with an outside advisory and consulting firm, a plan sponsor has the opportunity to request a bid on their plan from the existing recordkeeper. The outside consultant should have the opportunity to contact the existing recordkeeper (without disclosing the name of the company), ask for a bid as if the recordkeeper were quoting new business and were in a competitive bidding situation for a plan that had the same characteristics of existing company.

In a recent example, a plan was being charged .43% for record-keeping services and .25% for advisory services from their existing service providers. Upon conducting a blind RFI, a new quote for this business (from their existing recordkeeper) came in at .23% for record keeping services and .20% for advisory service. This lowered the total plan expense by .25% per year. In this instance, the plan could be paying .25% less for the same exact services. Since the plan is paying for the fees out of plan assets (i.e. participants are paying the fees), returns on participant investments are reduced by that extra .25% charge. How this might affect a participant over time can be seen in the following example:

Assuming a participant with an existing balance of $100,000 is saving $10,000/yr. until their eventual retirement in 20 years. The difference of an 8.00% return compared to 8.25% return to this individual equates to $37,000.

The loss to the individual is substantial. While a plaintiff's attorney may not find justification for bringing suit against a plan sponsor for $37,000, this company had over 500 employees that were adversely affected. This could represent damages of over $15 million to a class of participants. (500 X $37,000). This example makes a case for a plaintiff's law firm bringing a class action suit against the fiduciaries of this plan and a reason for the plan sponsors to regularly assess if their fees are reasonable.

A Full Scope Vender RFP

Considerably more time-consuming, the full scope RFP will allow a plan sponsor to not only compare fees from competing service providers, it will allow for a more detailed comparison of services available in the marketplace. Although time consuming, it provides the most comparative detail. One of the responsibilities of a fiduciary is choosing the right service provider for their retirement plan benefit. There are a variety of factors to consider when evaluating the capabilities of retirement plan providers, including recordkeeping services and features, communications, investment flexibility, compliance support and fees. The provider search process should provide a fresh look at the plans specific needs. Through this process several retirement plan providers can be evaluated for consideration. Proposals from each provider will be submitted for final evaluation including a comparison of provider services, product features and more importantly – fees. The entire process will be documented in a fiduciary file. All aspects of fees will be evaluated including plan recordkeeping and administration fees from revenue-sharing as well as fixed dollar costs. In addition, investment management expenses will be analyzed as well as advisory services in this process.

Evaluating the Fairness of Plan Fees

In a world of revenue sharing, it is important for plan sponsors and fiduciaries to recognize where the fees are coming from and how they're being assessed against participants. ERISA Section 404 (A)(1) states: A fiduciary must act for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying the reasonable expenses of administering the plan. The exclusive benefit rule and the embedded ERISA duty of loyalty prohibits any form of self-dealing. Fiduciaries must act with the skill, care, prudence, and diligence under the circumstances then prevailing of a prudent expert. While revenue-sharing is a generally accepted practice, the inequality of revenue sharing that exists among the funds in a line-up can create an unfair payment of plan fees by certain participants, depending on which fund they invest in. The challenge is best shown in the following example in Table 2.

Table 2- excerpted sample plan line-up

FUND NAME	ASSETS	TOTAL INVCOST	TOTAL_BPS REVENUE SHARE	REVENUES
Stable Value Fund Series 25053 - Class 15	$ 4,885,610.00	$ 37,619.20	0.0015	$ 7,328.42
Total Return Bond Fund - Class I	$ 8,038,942.00	$ 35,371.35	0.001	$ 8,038.94
Bond Fund - Class Y	$ 85,290.00	$ 656.74	0.0025	$ 213.23
Retirement Income Fund - Select Class	$ 4,725.00	$ 31.19	0.0025	$ 11.81
Retirement 2015 Fund - Select Class	$ 152,140.00	$ 1,080.20	0.0025	$ 380.35
Retirement 2055 Fund - Select Class	$ 2,511,945.00	$ 21,100.34	0.0025	$ 6,279.86
Dividend Fund - Institutional Class	$ 10,491,489.00	$ 73,440.43	0.0025	$26,228.72
Index Fund - Institutional Class	$ 17,623,977.00	$ 7,049.59	0	$ -
Large Growth Fund	$ 10,826,344.00	$ 69,288.60	0.0025	$27,065.86
Value Fund - Class I	$ 1,781,275.00	$ 11,756.42	0.001	$ 1,781.28
Opportunities Fund - Institutional Class	$ 15,119,877.00	$137,590.88	0.0025	$37,799.69
Small Cap Value Fund - Advisor Class	$ 7,325,715.00	$ 61,536.01	0.0025	$18,314.29
Small Company Fund - Class Z	$ 1,734,566.00	$ 14,396.90	0.0025	$ 4,336.42
International Fund - Administrative Class	$ 12,306,809.00	$123,068.09	0.0025	$30,767.02
Developing Markets Fund - Class Y	$ 2,030,491.00	$ 23,553.70	0.0025	$ 5,076.23
Natural Resources Fund - Class Z	$ 2,042,733.00	$ 18,793.15	0.0025	$ 5,106.83
Real Estate Securities Fund - Class I	$ 2,052,964.00	$ 21,556.12	0.0025	$ 5,132.41
Total	$ 122,804,539.	$ 857,065.		$ 243,335

Table 2 is an illustration of a plan's investment menu, in which the lowest net cost to the plan is achieved using certain retail share classes. These funds use a higher revenue share to offset plan expenses. The unfair practice occurs when there are one or more funds in the plan in which there is no revenue being taken from investment returns to offset plan fees. In this example, participants who choose active management are assessed the plan's fees due to the practice of revenue-sharing to subsidize those participants in the index fund who are not paying any of the plans expenses. They get a free ride at the expense of the other participants.[4] In this example, the most equitable solution is to take the revenue-sharing that is generated from the participants' account whose investment generated the revenue sharing. Then, the plan can allocate the recordkeeping fees equally among all participants by an equal charge to all accounts. For example, if an employee has $10,000 invested in Large Growth Fund paying the plan back .25% in revenue sharing, then the employee in the Large Growth Fund should get the credit. The practice of evenly distributing fees amongst plan participants either on a per participant basis or pro rata basis is the next evolution of managing fees on a plan.

By undertaking the three methods of evaluating fees, plan sponsors have a way to determine if the fees paid to retirement plan services providers are reasonable. In part 2, the fiduciary considerations for investment policy development and menu oversight will be presented.

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[4] Reish and Ashton "Fiduciary Challenges For Evaluating Plan Fees: Investment Expenses and Revenue Sharing" April 2015.