



# MINIMIZING RISK, MAXIMIZING STEWARDSHIP

**An Effective Strategy for Plan Sponsors in a  
New Regulatory Age**

**Part Two of a Three-Part Series**

## The New Regulation

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## Bracing for Impact: A Sea Change for Plan Sponsors

Part one of Roland|Criss' white paper series on the new Department of Labor ("DOL") fee disclosure regulations outlined the real effect these rules have on plan sponsors – not just their vendors – in 2012. Under the new 408(b)(2) rule, vendors must alter the way they prepare and distribute certain types of information to plan sponsors. Little mention has been given, however, to the enormous change these rules set in motion for plan sponsors and their overall fiduciary responsibility.

Previously, the mere receipt of vendors' reports provided plan sponsors with a sense of security regarding their fiduciary duty. Under the new regulation, however, plan sponsors are expected not only to ensure the receipt of their vendors' reports, but also to prove that they reviewed the reports, decided on the adequacy of the reports, and concluded that their vendors' fees are reasonable. This represents a sea change in the plan sponsor's role, and requires an entirely new level of diligence, training and accountability. Due to the extraordinary effort the new regulations require of plan sponsors, Roland|Criss dubbed the 408(b)(2) fee disclosure rule the "fiduciary supply chain management law," as a more fair rendition of its implications for the fiduciary community.

Part two of Roland|Criss' white paper series will address the action that plan sponsors can and should take to satisfy their revised fiduciary requirements under the new DOL regulation. It will also demonstrate how plan sponsors' approach to the new rule can serve as an effective risk management strategy, while enacting effective stewardship principles.

## Taking Action: Determining the Path of Least Resistance

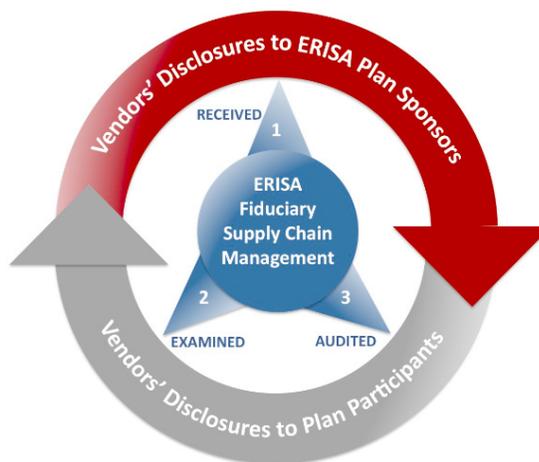
There are several different approaches plan sponsors may implement in order to be in compliance with 408(b)(2). As previously discussed, the new regulation requires the following ongoing actions of plan sponsors (also depicted in Figure A., below):

1. **Verifying** that they have received the appropriate disclosures from vendors;
2. **Testing** that these disclosures are adequate under the new rule; and
3. **Determining** that the fees provided within the disclosure are reasonable, or fair, given the vendor services rendered.

## Plan Sponsor Strategies

Plan sponsors have three strategy options: 1) a self-governing approach, 2) an outsourced approach, or 3) a combined approach.

Figure A. Fiduciary Supply Chain Management



Steps two and three – testing the adequacy of vendors’ disclosures and determining the reasonableness of their fees – are the most foreign requirements to plan sponsors, who traditionally only have confirmed the receipt of these disclosure reports. Hence, these steps also require the most learned knowledge and adaptation. In order to fulfill these new duties, plan sponsors generally have three strategy options: 1) a self-governing approach, 2) an outsourced approach, or 3) a combined approach. We will now explore these three strategies, including the benefits and disadvantages of each.

### Self-Governing Approach

The self-governing approach to fulfilling fiduciary duty under the new DOL rule places the onus on the plan sponsor to effectively interpret and monitor its vendors’ practices and fees. This approach provides an obvious benefit, as it employs current resources and does not require the involvement of a third party. The disadvantage of this approach, however, is the risk that is inherent in wholly absorbing this type of responsibility. Plan sponsors who have not been trained in how to interpret vendor reports, ask the appropriate probing questions, or understand how fees are constructed are not qualified (and cannot be expected) to effectively implement a self-governing strategy. And here’s the catch: most plan sponsors indeed have not been trained in these types of skills.

ERISA was originally constructed with the intention of allowing plan sponsors to remain focused on their businesses and core leadership skills, while deferring to “experts” in the fiduciary field to guide them in their retirement plan management. Instead of qualified third party administrative fiduciaries playing this integral role, vendors (including investment advisors, investment managers, and recordkeepers) have effectively inserted themselves into this role as a deceivingly trustworthy partner. In reality, the new DOL regulations have been enacted in an effort to counter vendors’ information advantage over plan sponsors, as well as many vendors’ predatory pricing practices – which concretely denounces them of their assumed trustworthy advisor status.<sup>1</sup>

<sup>1</sup> *Federal Register* July 16, 2010, page 41619

## The Outsourced Approach

The benefits of the outsourced approach are plentiful – minimized risk of fiduciary liability, peace of mind regarding plan participants' maximized funds, and a lessened "to-do" list of items that fall outside of corporate leaders' expertise areas.

The viability of the self-governing approach is lacking substantial evidence. Without so much as a single training session to orient plan sponsors toward their new duties, the self-governing approach places plan participants at a disadvantage and plan sponsors in a dangerous position of liability. The next strategy – the outsourced approach – will counter these risks and demonstrate a very different type of philosophy toward fiduciary supply chain management.

### *Outsourced Approach*

The focus of the outsourced approach is to minimize plan sponsor responsibility, while maximizing stewardship practices and mitigating risk. Working with an independent administrative fiduciary, this approach entails a combination of the following:

- Training on key fiduciary concepts and procedures,
- Outside monitoring of vendors' practices and fees, and
- An annual audit that evaluates plan sponsor compliance and current vendors' value (measured by assessing services rendered against fees charged during the same time period).

The benefits of the outsourced approach are plentiful – minimized risk of fiduciary liability, peace of mind regarding plan participants' maximized funds, and a lessened "to-do" list of items that fall outside of corporate leaders' expertise areas. The drawback to an outsourced approach is the fee paid to an outside third party. Many administrative fiduciaries, however, can demonstrate the ROI of their fees by the savings they obtain through more efficient vendor practices and decreased vendor costs. In addition, plan sponsors experience the invaluable advantage of offloading full fiduciary liability to the third party administrative fiduciary.

### *Combined Approach*

The third strategy for fiduciary supply chain management, the "combined approach," couples the independence of the self-governing approach with the safety and assurance of the outsourced approach. With this strategy, the plan sponsor undergoes an initial training as well as annual audits, but does not release full fiduciary responsibility to the third party administrative fiduciary. In this approach, the administrative fiduciary provides added risk management through an annual audit process, during which it can determine current vendors' value, and make suggestions for vendor changes or management process adjustments as needed.

## Utilizing Your Approach as a Risk Management Tool

With the assessment of fee "reasonableness" as a mandate of the 403(b)(2) rule, it is assumed that the majority of plan sponsors would rule out the self-governing strategy as a feasible option for effective compliance. The investment management industry is constructed with extremely complex processes and fee arrangements that require specialized expertise to properly interpret and understand. As referenced in Roland|Criss' first paper in this series, the DOL's Federal Register report published July 16, 2010 outlined in detail the danger of the information advantage that the vendor community maintains over its plan sponsor clients. Presuming that plan sponsors require the aid of an independent outside expert, the outsourced or the combined approach are the two remaining actionable strategy options for plan sponsors going forward.

Both the outsourced approach and combined approach can be utilized as effective risk management tools for corporations, plan sponsors, and plan participants. The common link between both approaches is the annual audit of fiduciary practices, so we will now delve deeper into how this component helps to increase fiduciary best practices while mitigating fiduciary liability and other investment risk.

## Risk Management Audit

A fiduciary audit is tangible evidence that stands against any potential DOL investigation or allegation.

The idea of an audit clearly is not a new theory. Many industries utilize audits to manage and measure themselves consistently against set standards of conduct, performance, or both. Financial audits are a longstanding endeavor of the corporate world, with a comparable business case to the fiduciary audit: to support and ensure a baseline of pragmatic (in this case, accounting and management) practices.

An audit in the fiduciary realm follows these same principles. It evaluates several different key metrics of the plan sponsor role, namely:

- The consistency of value delivered by the plan sponsor vendors;
- The appearance of any vendor conflicts of interest and their potential harmful effects on the plan or its participants;
- The reasonableness of the plan vendors' fees;
- The effectiveness of the plan vendors' practices; and
- Any areas that fall below the standard as set by ERISA.

The benefits of a fiduciary audit are most tangible to plan sponsors and plan participants. The plan sponsor is insulated from fiduciary liability, gains valuable insight regarding any management practices that should be adjusted, and learns of those vendors that are not acting in the best interest of the plan's participants. Plan participants are ensured that they are being charged reasonable fees for the management of their retirement plan, thus maximizing their investment power. Finally, a fiduciary audit is tangible evidence that stands against any potential DOL investigation or allegation (which, although it should be a worst-case scenario, realistically is occurring with increasing frequency across all industries).

### **The Winning Strategy: Less Responsibility, More Peace of Mind**

Both the outsourced approach and the combined approach to fiduciary supply chain management offer the plan sponsor peace of mind amidst the confusion and complexity of the new rules – to know that participants' investments are maximized, fiduciary responsibility is fulfilled, and liability is mitigated. The key to this formula is selecting a truly independent administrative fiduciary – one that has no ties to investment advice or investment funds – that can be the objective source, working solely in the best interest of the plan sponsors and their participants. This strategy allows for plan sponsors to regain focus around their paramount priorities – the security and proliferation of their business, and achieved success in their role as leader and steward.

*Stay tuned for Part Three of this series from Roland|Criss, which will be published in January 2012.*