



# THE ROI OF A 408(B)(2) AUDIT

Part Three of a Three-Part Series

## The Key to An Effective Risk Management Approach

Part two of Roland|Criss' white paper series outlined three differing plan sponsor strategies for fulfilling fiduciary obligations under the new 408(b)(2) fee disclosure rule. The **self-governing approach** entails no use of outside fiduciary advisors, instead relying solely on in-house leadership to understand, develop and properly execute a 408(b)(2) compliance strategy. By contrast, the **outsourced approach** completely offloads fiduciary responsibility (and liability) to a qualified, independent third party. Finally, the **combined approach** offers a compromise – to fulfill most fiduciary responsibilities in-house, but engage an independent fiduciary advisor to review and assess fiduciary practices at least once per year.

Only two of the three fiduciary strategies – the **combined approach** and the **outsourced approach** – provided holistic solutions for minimizing risk, ensuring compliance with 408(b)(2), and providing plan sponsors with peace of mind regarding their fiduciary responsibility.

The common link between these two approaches? An annual 408(b)(2) audit.

The 408(b)(2) audit allows for the objective and careful examination of key practices, vendor agreements, and vendor effectiveness for retirement plan sponsors – who often juggle multiple responsibilities, roles and even liabilities at the executive level. The audit enables an independent third party to bear the burden of ensuring that the plan sponsor organization complies with 408(b)(2) and aligns with proper standards for fiduciary practices. In short, the 408(b)(2) audit has become a necessary insurance policy for a plan sponsor's fiduciary liability.

This paper will discuss the benefits of the 408(b)(2) audit, and utilize a real-world case study to illustrate how the 408(b)(2) audit represents a true return on investment for plan sponsors.

### Audit Benefits: Worry-Free Fulfillment of 408(b)(2) Requirements

As noted in our previous papers, the new regulation requires three actions of plan sponsors in relation to the monitoring of their vendors' fees: 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** whether the fees provided within the disclosure are reasonable, or fair, given the vendor services rendered.

## How Plan Fees Are Paid

A particularly enlightening discovery during the 408(b)(2) audit often is related to learning the ratio of employer-paid fees vs. plan-paid fees.

The key challenge inherent in these requirements is the assumption that plan sponsors will know how to interpret and assess their vendors' reports and fees – a responsibility with which they have no experience and that previously did not fall on their shoulders. The 408(b)(2) audit tackles this issue head-on, providing plan sponsors with a failsafe assessment of their vendors and a go-forward solution for meeting the three requisites of the new regulation. Let's explore the audit benefits in more detail.

### *1) Clarifying and Updating Vendor Arrangements*

While most plan sponsors are familiar with ensuring the receipt of vendor disclosures, many are unfamiliar with testing the adequacy of these vendor documents under the new rule. The first benefit of the 408(b)(2) audit is the vital identification and assessment of existing vendor arrangements. For some plan sponsors who have maintained a longstanding vendor relationship, it is difficult to locate or interpret their original signed contract. Furthermore, many existing vendor arrangements are not defined in writing making compliance with the rule nearly impossible. The audit process enables plan sponsors to fully understand the terms of their vendor contracts, as well as update and revise them, where needed.

### *2) Illuminating What and How Plan Fees Are Paid*

Due to the complex nature of vendor fee structures and service models within the retirement plan industry, it is often difficult to discern exactly what fees are being charged for which services, as well as from where those fees are being extracted. A particularly enlightening discovery during the 408(b)(2) audit often is related to learning the ratio of employer-paid fees vs. plan-paid fees. Although many plan sponsors assume their vendor fees are taken exclusively from the company pocket, there are many arrangements that generate vendor payment directly from plan assets – which translates to a reduced amount of investable assets for plan sponsor participants. One of the most valuable takeaways of the 408(b)(2) audit can be understanding and challenging these unbalanced or unfair plan-paid fees.

### *3) Analyzing Vendor Value*

The most revolutionary offering that is available with the 408(b)(2) audit revolves around garnering a score that assesses a particular vendor's performance. The audit provides plan sponsors with an objective analysis of their vendors' fees based upon a scientific calculation of value (i.e., services delivered vs. fees rendered over the same specific time period). With this calculation, plan sponsors not only are able to view fee trends over a certain amount of time (i.e., "we have been overpaying in a particular area of our plan for three consecutive years"), but they are equipped with the knowledge of whether their vendor's fees are "reasonable" as defined by ERISA. This in-depth analysis virtually never has been available to the plan sponsor market prior to 408(b)(2), and is changing the way plan sponsors select and monitor their vendors.

## Measuring the ROI

The 408(b)(2) audit places in a distinctively advantageous position those plan sponsors that are required by ERISA to obtain an annual CPA's financial audit for their plans.

### 4) *Enhancing Positioning for ERISA Audit*

A tangible result of the 408(b)(2) audit is that it proves that a plan sponsor is working to adhere to a high level of fiduciary care and comply with the new regulations. The 408(b)(2) audit report stands as firm testimony to a plan sponsor's intention to adequately fulfill fiduciary responsibilities and update policies as needed when regulatory changes occur. The 408(b)(2) audit places in a distinctively advantageous position those plan sponsors that are required by ERISA to obtain an annual CPA's financial audit for their plans.

### **Case Study: Real-World Benefits of a 408(b)(2) Audit**

#### *Situation*

A healthcare organization ("HCO") was the target of heavy competition by a crowd of retirement plan service providers. The HCO sponsored a 401(k) and pension plan for its employees. The plan fiduciaries were comprised of both medical and business professionals who took to heart their roles as stewards on behalf of their employees.

The HCO's executives listened to the plan vendors promise better benefits for a cheaper cost. While they sensed these claims might have been too good to be true, they wanted to demonstrate an objective process for evaluating current fees and service levels as a first step before engaging in a time-consuming and costly request for proposal process.

#### *Approach*

The HCO engaged an independent fiduciary audit partner in order to implement its 408(b)(2) audit. By doing so, the HCO was able to establish an objective process, rooted and substantiated in ERISA mandates. Furthermore, the process would demonstrate to stakeholders and regulatory agencies the executives' adherence to a standard of excellence.

The independent fiduciary audit partner worked primarily with the CFO, who served as the liaison with plans' vendor supply chain. With the use of its data collection system, provider review criteria, and fee benchmarking resource tool, the fiduciary audit partner efficiently verified, tested and opined on the reasonableness of the plans' service providers' fees.

#### *Result*

The 408(b)(2) audit resulted in powerful outcomes and directives for the HCO's executives, including:

- Creating a common language for the plans' fiduciaries and an awareness of the murky and complex fiduciary burdens,
- Clarifying the service providers' roles and accountabilities.
- Simplifying the fiduciaries' understanding of fee types, categories, and direct and indirect revenue received by providers,
- Upgrading and enhancing current service agreements and establishing effective performance metrics.
- Generating a 30% reduction in plan expenses by eliminating duplicitous functions and establishing more precise deliverables.



## How Do We Measure the ROI of Confident Peace of Mind?

Amidst all of the hype and discussion that has surrounded the establishment of the 408(b)(2) rule, one truth remains: the new fee disclosure rule requires just as much – if not more – effort and diligence from plan sponsors as from their vendors. Additionally, plan sponsors typically are not trained in understanding the intricacies of the vendor world, including investment jargon, complex fee arrangements and conflicts of interest. Executive teams are trained to excel in their leadership role – and this often requires deft delegation and collaboration across all levels of the organization. The fiduciary role can be intimidating, with its far-reaching implications and inherent liabilities. However, there are trusted, independent partners that can help plan sponsors to maintain their focus on the big picture, while ethically and transparently tending to the details that are so critical to fulfilling fiduciary duty. The 408(b)(2) audit may be the vehicle, at last, for a much-needed introduction between the droves of well-intentioned plan sponsors and their trusted fiduciary solution.