The Correct Approach for Controlling Retirement Plan Fees

When employees file complaints against their employers with the U.S. Department of Labor, fees for their retirement plan services is a very common reason. A burgeoning era of employee activism is underway in which plaintiff lawyers are finding fertile ground for litigation opportunities, catching many employers unprepared. Many other employers are ready, however, using an approach that offers a legally defensible result.

by Ronald E. Hagan

Ronald E. Hagan is Chairman of the Risk Standards Committee of Roland|Criss, which is the premier risk manager for retirement plan sponsors, foundations, and endowments. Ron has a lengthy career in risk management, and has pioneered many of the certification, standards practices, and fiduciary risk management strategies that are preferred by boards of directors and human resources executives. He is the host of The Excellent Fiduciary podcast on Stitcher, Google, and iTunes. He can be reached at ronhagan@rolandcriss.com.

Article Summary

Enterprises that sponsor retirement plans are required to protect their employees from excessive fees associated with their 401(k) and 403(b) type plans. The failure to fulfill the steps required by a critical Department of Labor's (DOL) regulation, which I'll refer to in this article as the "Reasonable Fee Rule," is a breach of fiduciary duty and a violation of the Employee Retirement Income Security Act ("ERISA"). Organizations that have achieved advanced levels of governance, risk management, and compliance (GRC) in their fiduciary role have realized significant benefits, especially in their plans' costs. This article will provide a brief background of the Reasonable Fee Rule and it will update awareness of what the rule requires from plan managers.

Managing Retirement Plan Costs: A Sea Change for Plan Sponsors

The Reasonable Fee Rule, which is found in ERISA section 408(b)(2), was added to ERISA seven years ago. Since then, there have been many articles published about its impact on fiduciary risk management. While a definition of how to determines if a vendor's fees are

reasonable was not codified, one thing is very clear: employers inherited a sea change in their fiduciary role and responsibilities.

Origination of the Rule: Closing the 'Information Gap'

Over the past three decades, there has been an information disadvantage, what the DOL terms an 'information gap' in the ERISA market between retirement plan sponsors and their vendors. The DOL has revealed its concern in an unprecedented public report to qualified plan fiduciaries, in which the DOL used pointed language to illustrate the potential danger inherent if the information gap persists between a plan sponsor and the plan's service providers.

The Reasonable Fee Rule is the DOL's reaction to these findings and its subsequent effort to minimize the information gap before additional damage is incurred by plan sponsors and, more importantly, their participants. The rule impose a hefty responsibility on plan sponsors - requiring them to become more involved and scrupulous with their vendors in order for the rule to have its intended positive effect on the market.

What the Reasonable Fee Rule Mandates for Plan Sponsors

Vendors like to refer to the 408(b)(2) regulation as the 'fee disclosure rule.' That term is somewhat of a misnomer for plan sponsors. The term implies that the primary onus for compliance lies on vendors to disclose proper and fair fees to their plan sponsors. This is only part of the dictate of the rule. The more important and impactful mandate for plan sponsors is what the rule requires of them after vendors' fees have been disclosed. Plan sponsors are required to determine if the fees actually paid to a vendor from a plan's assets are merited based on the quality of the services the vendor delivers. In other words, are the fees reasonable.

Specifically, the Reasonable Fee Rule requires the following ongoing actions of plan sponsors (also illustrated in Figure A, below):

- **Verify** that they have received the appropriate disclosures from vendors;
- **Test** that these disclosures are adequate under the new rule; and
- **Determine** that the fees provided within the disclosure are reasonable, or fair, given the services rendered by a vendor.

Each time vendors' costs are evaluated (ideally annually) the steps used should be documented and maintained in the plan's fiduciary file as a defense, if and when the DOL conducts a plan audit.

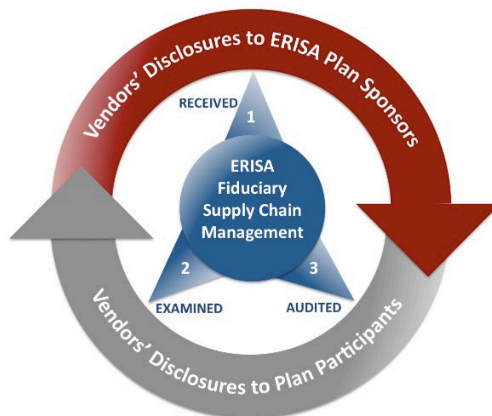

Figure A. Fiduciary compliance steps for the Reasonable Fee Rule

Previously, the mere receipt of vendors' reports gave plan sponsors a sense of security regarding their fiduciary duty. Under the rule, 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. Next, we will address the action that plan sponsors can and should take in order to satisfy their revised fiduciary requirements under the Reasonable Fee Rule, while minimizing risk and enacting effective stewardship principles.

Benchmarking fees alone is not the right approach

Plan sponsors have a variety of choices regarding their approach to fulfilling their duty as primary fiduciaries. They may engage an ERISA Section 3(16) Fiduciary. If independent from providing other services to a plan, such a firm is able to accept total responsibility for the operation of the plan, which includes such duties as the hiring of service providers, ensuring appropriate and timely filings, and handling disclosures. The 3(16) Fiduciary operates the plan, rather than the plan committee, business owner or board of directors. The employers' only responsibility is to select and monitor the 3(16) Fiduciary prudently.

Alternatively, plan sponsors can combine their internal practices with occasional counsel from an independent Administrative Fiduciary, or they can choose to undertake all of the responsibility

and have annual ‘spot-checks’ to ensure their practices are prudent and in line with current fiduciary law.

Regardless of the avenue plan sponsors choose for fulfilling their fiduciary duty, the safest way to ensure that they earn the prohibited transaction exemption embedded in the Reasonable Fee Rule is to have a certified GRC professional that specializes in ERISA plans conduct an annual assessment. Specifically, such an assessment analyzes:

- More than just a comparison of a vendor’s asset based charge against its competitors;
- The consistency of value delivered by a vendor;
- 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 taking into account the dollars paid for the quality of the services it delivers;
- The effectiveness of the plan vendors’ practices; and
- Any areas that fall below the standard as set by ERISA.

The most valuable tool produced by a fee assessment for plan fiduciaries to garner is a score that ranks a particular vendor's performance.

Let’s explore the assessment benefits in more detail

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 rule. The first benefit of the fee assessment is the vital identification and analysis 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 assessment process enables plan sponsors to fully understand the terms of their vendor contracts, as well as update and revise them, where needed.

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 fee assessment 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 compensation directly from plan assets, which translates to a reduced amount of investable assets for plan participants. One of the most valuable takeaways of the fee assessment can be understanding and challenging these unbalanced or unfair plan-paid fees.

Analyzing Vendor Value

The most revolutionary innovation in a fee assessment revolves around garnering a score that assesses a particular vendor's performance. This is vital, especially if a vendor's compensation is computed as a percentage of a retirement plan's assets. The assessment 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 the rule's introduction and is changing the way plan sponsors select and monitor their vendors.

Enhancing Preparation for a Department of Labor Audit

A tangible result of the fee assessment is that it proves that a plan sponsor is working to adhere to a high level of fiduciary care. Since the fee assessment report is a legally bound opinion by the GRC professional, it 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 fee assessment places in a distinctively advantageous position those plan sponsors that are attentive to all of ERISA's plan operations requirements.

Relief from Breach of Fiduciary Duty

In a strangely seeming 'Catch 22,′ ERISA prohibits payments from the assets of a qualified plan to a so-called party in interest. Vendors are parties in interest if their compensation is derived from a plan's assets. The only relief that plan sponsors may obtain from ERISA's heavy penalty for harboring a scenario that pays vendors from their plans' assets is to document an analysis and conclusion that the vendors' fees are reasonable. A fee assessment provides an unbiased view of vendors' fees, guides a plan sponsor on how to react to the findings, and activates the exemption.

Conclusion

The Reasonable Fee Rule, no doubt, impinges on both the plan sponsor and vendor communities, requiring from them much more effort and diligence than ever before. For plan sponsors, especially, the fiduciary role can be intimidating, as it typically couples potential liability and changing laws with a lack of in-depth training on fiduciary principles or vendor management skills. To the extent that vendors and plan sponsors can align their focus on stewardship principles and work together toward maximizing stakeholder value, this relationship will grow in trust and prove to be invaluable in the years ahead. Instead of viewing the Reasonable Fee Rule as an increased burden, vendors and plan sponsors may view it as an opportunity to mend a relationship that has been misaligned for many years. Faithfully complied with by plan sponsors, the rule will also enhance retirement outcomes for their employees.

(Note: Roland|Criss offers fees assessments that carry legally defensible opinions. Ask for information at: rolandcriss.com/contact-us.)