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Beware of Free 401(k) Plan Benchmarking Services-

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Summary: Earlier this year I had the opportunity to speak as a panel member on the new Participant Fee Disclosure Rules at the **Retirement and Benefits Management Seminar** that was held in Charlotte. This conference is sponsored by the University of South Carolina's Darla Moore School of Business with participation by the U.S. Department of Labor and the Internal Revenue Service. One of the side-points I made to an audience of employers was that... as a *consequence* of the increased amount of fee information being made public via the Form 5500 (which is now available online), you can anticipate selling efforts will intensify. These efforts are masked as a "consulting exercise" to help with fiduciary governance through Plan Benchmarking Reports. Simply be aware of this circumstance before you make evaluation judgments based upon the content of these reports. In it not unreasonable to question the motives of those which provide such reports for free.

One of the more commonly addressed fiduciary topics today is the duty for fiduciaries to assess the reasonableness of expenses in their 401(k) retirement plan; especially since plan participants most often absorb the costs through hidden investment-related fees. These hidden expenses have garnered the attention of the media, lawyers, industry regulators, and Congress. Consequently, regulators are requiring increased disclosure, reporting and oversight of plan costs.

With the rapid pace of regulatory mandates for adequate fee disclosure within 401(k) plans, more plan cost data is now publically available. Given the ease of access to such cost data, a number of consulting firms have developed an array of reporting tools to "assist" plan sponsors in managing their fiduciary duties; including the duty to assess the reasonableness of plan fees. Unfortunately, in our view, some consulting firms and financial service organizations are using these reporting tools as a guise for fiduciary consulting; when in reality, it is a framework to promote low-cost, low-turnover investment products from certain mutual fund families. While there are many benefits to considering the use of low-cost, low-turnover investment products in a retirement plan, plan sponsors need to be mindful that some of these "fiduciary exercises" are, in essence, the presentation of a one-sided argument espousing the benefits of a passive investment philosophy under the mask of consulting.

The "Plan Benchmarking Reports" (using data obtained from Form 5500 filings) are created by several independent financial information companies, which in turn, sell these reporting capabilities on a subscription basis to advisors seeking to attract new clients. The typical sales tactic is to identify problems and/or develop dialogue which implies fiduciary concerns relating to plan-related costs. One way they do this is to introduce "new" components of plan-related costs attributable to turnover ratios, trading costs, opportunity costs and market impact costs to the evaluation equation. This, of course, inflates the total plan costs.



Keep in mind that plan sponsors have a fiduciary duty to make sure any expenses incurred by the plan are “reasonable”. However, “reasonableness” of plan expenses does not mean or imply that your chosen service provider(s) must be the least expensive; rather, “reasonableness” is based upon both absolute cost and the relative value of the level of services, or performance, being provided.

Since the topic of retirement plan fees falls within the realm of fiduciary responsibilities, we present our opinions on this matter within the fiduciary context. The inference we detect from advisors using this approach is to set off the alarm in the plan fiduciary’s mind of increased fiduciary risk due to high investment-related costs.

Fortunately, there is an established authoritative source for the governance of ERISA fiduciary duties. In assessing the topic of the potential for increased fiduciary risk due to high investment-related fees, we will present guidance from this source regarding fiduciary conduct in the due diligence process and the specifics of the duty to determine reasonableness of plan fees.

Authoritative Resources

The administration of the Employee Retirement Income Security Act of 1974 (ERISA) is divided among the following government organizations: the U.S. Department of Labor (DOL), the Internal Revenue Service of the Department of the Treasury (IRS), and the Pension Benefit Guaranty Corporation (PBGC).

For our purposes, it is important to note that it is the DOL, through its Employee Benefits Security Administration (EBSA) division, that is charged with the responsibility for administering and enforcing the rules for *reporting and disclosure*, vesting, participation, funding, *fiduciary conduct*, and civil enforcement. The DOL, therefore, is the relevant authoritative source in this matter.

ERISA’s Fiduciary Standard of Conduct

A fiduciary is subject to the prudent person standard of conduct. In other words, a fiduciary must act “with the care skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.” - ERISA 404(a)(1)(B).

DOL Required Disclosures

On July 16, 2010, the Department of Labor issued its interim final rule (ERISA 408(b) (2)) to help Plan Sponsors actually obtain sufficient information from service providers by mandating that each service provider disclose the fees they receive to Plan Sponsors.

Under the new regulations, any 401(k) service provider would have to disclose all services to be provided and, with respect to each service, the compensation and the manner of receipt of such compensation. The DOL has provided a sample **401(k) PLAN FEE DISCLOSURE FORM** for fiduciaries to use in compiling the fee information.



It is important to note that neither the 408(b)(2) regulation, nor the sample **401(k) PLAN FEE DISCLOSURE FORM**, impose the duty upon fiduciaries or service providers to obtain and consider the component investment costs attributable to turnover ratios, trading costs, opportunity costs and market impact costs in the determination of reasonableness of fee arrangements.

In light of the **Fiduciary Standard of Conduct** and the **DOL's Required Disclosures**, it is our view that the high-cost issues identified by some advisors as a scare tactic, in fact do not represent a fiduciary risk to the fiduciary committee. We hold this view primarily for two reasons:

- 1- The cost analysis put forth within some of these "Plan Benchmarking Reports" is inconsistent with the prevailing fiduciary standards which another hypothetical prudent expert would exercise under similar circumstances. Few consultants and advisors ever attempt to impute the cost of turnover ratios, trading costs, opportunity costs and market impact costs into their plan cost analysis. If you read the footnotes in some of the "Plan Benchmarking Reports" you will see their own acknowledgment that their calculations are only estimations and not actual quantifiable costs. We do not, therefore, believe that the plan's fiduciaries have acted imprudently merely by not considering these cost components in their consideration of reasonableness of plan costs.
- 2- The DOL, the authority ultimately concerned with fiduciary conduct and disclosure, does not currently address or consider these components of investment costs (turnover ratios, trading costs etc.) as relevant to the determination of reasonableness of plan fees. Therefore, from the strict standpoint of fiduciary risk, this issue of additional component investment costs is irrelevant.

Our Conclusions

This is not to say that the points raised by such advisors are not without any merit or consideration. These points may indeed be valid or even worthy of consideration in the selection process for investment products for the plan's menu of options. However, from a fiduciary risk management perspective, these points are distractions and we would even suggest misleading to further infer some deficiency in disclosure by the existing 401(k) service provider or the fiduciary committee for lack of conformance with the disclosure regulations of 408(b)(2).

For further inquiries, please call us at 864-552-4020.

PrimeTRUST Advisors is an independent retirement plan consulting and investment advisory services firm. We are committed to advancing awareness of fiduciary standards of care through writing articles, giving presentations, facilitating fiduciary training programs and in practice with our clients. Visit our website for additional information, background and relevant articles at www.primetrustadvisors.com.