

## Tips for Plan Sponsors

Retirement plan sponsors face mounting pressure to ensure that the fees they pay to their plans' service providers are reasonable.

### What Every Plan Sponsor Should Know about "Reasonableness of Fees"

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Dallas, Texas

#### **Who is a Service Provider?**

*On January 1, 2009 the Department of Labor's new proposed Regulation 408(b)(2) will take effect. It will define ERISA's demand on plan sponsors that their Service Providers' fees be "reasonable." It will also require that plan sponsors test their Service Providers' conflicts of interest to evaluate if the conflicts are acceptable.*

*The Regulation defines who fits the category of a Service Provider. The list includes:*

- 1. Any person or entity who is deemed a fiduciary by ERISA;*
- 2. Any person or entity who is deemed a fiduciary by the Investment Advisers Act of 1940;*
- 3. Any provider of recordkeeping, TPA, investment management, securities brokerage, custody of assets, consulting, insurance or banking services;*
- 4. Any provider that is paid indirectly and delivers accounting, audit, actuary, legal, appraisal, or valuation services.*

#### **Are Your Plan's Service Providers' Fees "Reasonable"?**

By now, most companies that sponsor a retirement plan qualified by the Employee Retirement Income Security Act ("ERISA") are aware that the Department of Labor's new proposed Regulation 408(b)(2), or simply the "Regulation", is coming soon.

The Regulation demands unprecedented disclosures of information by firms and individuals that deliver services to ERISA plans (*please see the insert to the left which shows who will be required to make the disclosures*). The disclosures that will be made to you will focus on compensation paid to your Plan's Service Providers, both direct and indirect, and their conflicts of interest with your Plan. It is possible that the information will overwhelm you, and even disturb you.

This issue of TIPS focuses on the impact that the Regulation will have on your duty to determine the reasonableness of the fees earned by your Plan's Service Providers. Ensuring that fees paid by an ERISA plan's participants are fair is a long standing duty of a plan's officials. The current lack of full disclosure of fees by Service Providers, complex vendor structures, inadequate management processes among plan sponsors, and the absence of a neutral fee benchmark have left a vital fiduciary duty unfulfilled throughout the ERISA plan community. Plan sponsors are suffering. The number of lawsuits and enforcement sanctions against them continue to spiral upward. Participants are suffering. Unjustified fees bite into their investment returns and unfairly deplete their retirement savings.

Recent lawsuits against plan sponsors for breach of fiduciary duty reveal that many plan officials have little knowledge of how to determine "reasonableness of fees." More damaging is the Department of Labor's discovery in recent years that few fiduciaries even try to figure out what is reasonable. It found that many plan sponsors operate under the mistaken belief that they satisfy their fiduciary duty by hiring only the lowest cost providers.

The Regulation sets plan officials straight on what is required of them. It demands that plan officials investigate and understand their Service Provider arrangements including how the providers are paid. While this will be difficult enough, the tougher part will be proving that fees paid to Service Providers are reasonable.

In light of the penalty imposed by the Regulation on plan sponsors for failing to show reasonableness of fees, where should you begin?

## ***Getting Started***

Before you start the job of determining the reasonableness of the fees that your plan pays to its Service Providers, you should understand the arrangement that exists with each provider. The Regulation requires that service agreements address the following mandates by January 1, 2009:

### **1. Service Contracts Must be in Writing**

Due to the expanded disclosure demands of the Regulation, most existing contracts between plan sponsors and their Service Providers will need to be rewritten. Don't wait until December 2008 to get started. Ask your Service Providers now for their contract forms that comply with the Regulation.

### **2. Services and Compensation Defined and Disclosed**

All services to be provided to the plan must be defined. For each service, direct and indirect compensation to be received by each Service Provider and its affiliates must be revealed.

### **3. Acknowledgement of Fiduciary Status**

Each Service Provider must disclose if it, or any of its affiliates, will provide services to the plan as a fiduciary as defined under either ERISA section 3(21) or the Investment Advisers Act of 1940.

### **4. Disclosure of Financial or Other Business Interest with Affiliates**

Service Providers must state if they or an affiliate will have any financial or other interest in any transaction to be entered into by the plan in connection with services covered by the Regulation.

### **5. Other Material Relationships**

Material financial, referral or other relationships with a money manager, broker or other Service Provider to the plan that creates or may create a conflict of interest must be disclosed.

### **6. Ability to Affect Own Compensation**

Service Providers must disclose if they have the ability to affect their compensation, or that of any affiliate, without the prior approval of an independent plan fiduciary.

### **7. Policies to Address Conflicts of Interest**

The Regulation requires the disclosure of each Service Providers' policies or procedures that address or prevent conflicts of interest.

### **8. Material Changes**

Within 30 days of any material change in the information required for disclosure each Service Provider must report it to the plan sponsor.

### **9. Reporting Assistance**

Any request for information made by a plan sponsor to its Service Providers must be complied with promptly. This is designed to ensure the prompt filing of Schedule C of the new Form 5500.

### **10. Actual Disclosure**

The Regulation requires that Service Providers actually make the disclosures that it demands. All disclosures required by the Regulation must be made prior to entering into an arrangement with an ERISA qualified plan.

The above list of requirements will cause plan sponsors to receive more information than ever before from their Service Providers. Since reasonableness of fees must be determined by some form of comparison of costs to comparable services, many of the items listed above will enter into the evaluation of fees. Consequently, plan sponsors need to investigate thoroughly their contracts and arrangements with investment firms, recordkeepers, custodians, trustees, insurance companies, actuaries, and professional advisors.

## ***Types of Fees and Their Characteristics***

Service Providers charge fees to plan participants' accounts in up to 4 ways. Services may be invoiced or they may be deducted directly from participants' account balances. Charges may be assessed on an annual, quarterly, or monthly basis. When fees are charged as a percentage of assets, they may be hidden or "bundled" as part of investment management fees or assessed in addition to the funds' expenses. When a

plan's administrative fees are bundled within the investment management fees, the payment of such fees is called a "soft dollar" payment which is also known in the industry as revenue sharing.

Less than 50% of plan sponsors surveyed earlier this year said they understand how employees' accounts are charged. Furthermore, 77% of the firms that participated in the survey said that they did not know how to determine if the fees charged are reasonable. Most of them said that they did not know how to evaluate if the fees paid are appropriate for the services that their Plan and its participants receive. Many even expressed doubt that they were receiving all of the services that they were paying to receive.

## ***Benchmarking Services and Fees***

Benchmarking vendors' costs is a long-standing management discipline that businesses of all sizes perform. Few persons, who obtain services or products for their employers, whether it is a manufacturing, distribution, or service business, would do so without knowing exactly what they are paying for. Yet the U.S. retirement plan industry is saturated with service arrangements that lack the slightest hint of competent comparison with alternatives. Reasons for this vary, but the most common excuse heard is "fees are too complex." In spite of the excuses, ERISA makes testing of fees for services a fundamental duty of primary fiduciaries. The Regulation is the first of several new ways that the U.S. government will use to force the use of benchmarking by all retirement plan sponsors.

### **The Risk:**

Based on Roland|Criss' experience, most plan sponsors will find themselves in one of three classes regarding the Regulation. There will be the class that believes; "*I do not have a fiduciary duty*" and will ignore the Regulation. Another class of plan sponsors will allow themselves to believe; "*my investment advisor/ recordkeeper/ custodian/ outside trustee is the fiduciary and the Regulation does not affect me.*" A third class of plan sponsors will evaluate information about the Regulation and take the steps necessary to ensure that their fiduciary processes are aligned with it. Regardless of the class in which you fit, get ready now. The legal community warns that the Regulation will make a ripe setting for lawsuits.

### **The Solution:**

Seek outside help if you do not have the internal capabilities to properly evaluate and benchmark your current Service Providers' fees and services. Now is a good time to get help in guaranteeing that your Plan's fees are reasonable.

Roland|Criss offers independent assessments of the reasonableness of the fees charged to ERISA qualified plans. Roland|Criss is not a vendor of any investment, recordkeeping, custodian, or trustee services. Its evaluations are unbiased. Learn more about how to improve your Plan's safety at [www.rolandcriss.com](http://www.rolandcriss.com).

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