

# Report

JULY 2014

*News and updates for plan sponsors and fiduciaries of defined contribution plans*

## DETERMINING FEE REASONABLENESS OF A RETIREMENT PLAN RECORDKEEPER

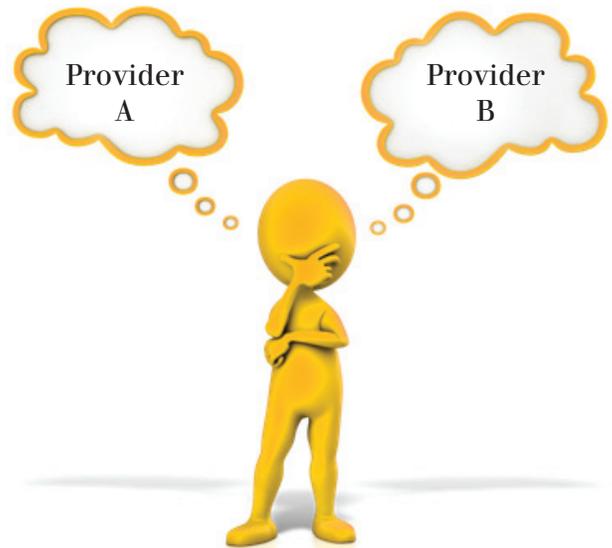
The determination of reasonableness of fees has always been a core fiduciary function for ERISA plan sponsors. ERISA Section 408(b)(2) regulations increased scrutiny on this responsibility. The Department of Labor (DOL) has taken this step to solidify specific requirements for plan sponsors and service providers, regarding communication of fee information.

### TIMING

The genesis of these regulations is found in proclamations by Phyllis Borzi, Assistant Secretary of the Employee Benefits Security Administration (EBSA) (the enforcement arm of the DOL). It is Borzi's contention that the monitoring of reasonableness of fees, services and contracts is not being adequately accomplished by plan sponsors. As a result, 408(b)(2) regulations now require that plan sponsors (fiduciaries) receive explicit and transparent documentation of all aspects of fees and expenses relating to services rendered by plan service providers. The focus of this article is on these regulations as they pertain to a plan's recordkeeper (who also facilitates access to a plan's investment options).

### PROGRESS ASSESSED

This well intended action by the DOL has not proven to be the panacea intended, partly because the regulations offer no definition for "reasonable." Also, many plan sponsors may have misunderstood the full intent of the DOL by assuming that mere receipt and review of this data fulfills their obligation. This is not correct. Included in these regulations is the very specific responsibility for plan sponsors to use this fee data to document the process and result of their



determination of reasonableness of fees, services and contracts.

The impact of Borzi's contention of nonperformance by plan sponsors is convincingly borne out of recent litigation where reasonableness of fees and services played a significant role. Court cases (Tussey v. ABB, Beesley v. International Paper, and several others pending) generated awards/settlements in the \$50M plus range against plan fiduciaries. Increased litigation activity is all but assured by Borzi's declarations and ensuing 408(b)(2)'s statement of fiduciary responsibilities. Now that 408(b)(2) has provided fiduciaries with explicit instructions regarding their responsibilities, there is no excuse for nonperformance. This is welcomed news for class action law firms

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## WHY ADVISORS ARE TAKING A NEW LOOK AT COLLECTIVE INVESTMENT TRUSTS

As many institutional investment advisors know, Collective Investment Trusts have been in existence since the 1970s.

Yet today's collective funds are becoming increasingly popular as plan sponsors and institutional investment advisors seek more efficient ways to provide plan participants with high quality/low cost investment options.

### WHAT HAS CHANGED

There are two reasons for collective funds growing popularity. First, the industry has eliminated many operational impediments that made collective fund performance difficult to monitor. Second, collective funds can now be traded via the NSCC and offer share class structures similar to those of mutual funds, yet at a typically lower cost.

This increase in share class structures provides advisors with considerable versatility. Some institutions offering collective investment funds to their clients, have seen an increased interest in risk based model portfolios, target date and index funds. This increased interest in these asset classes could be due to the following three key factors:



- **POTENTIALLY LOWER FEES** - Net expenses of index, risk-based and target-date funds have all trended lower for collective funds than for their mutual fund counterparts.
- **NO MINIMUMS** - A number of collective funds require no minimum initial investments from plans. This can be conducive to a wider application of the funds across an advisor's book of business.

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## LOCATING MISSING PARTICIPANTS

At one time or another all plan sponsors will likely be in the position of having to locate missing participants. This may be related to delivery of regulatory required communications, distributing of assets, or communicating fund changes to active and/or terminated participants. If the delivery of necessary communications is encumbered because a participant cannot be located there exists a fiduciary requirement to perform a "reasonable search" for this "missing" participant. There are various search methods that would be considered as reasonable good faith efforts, including:

- Certified Mail (with a return receipt) to the last known address
- Checking records of other benefit plans (i.e., employer provided health plan)
- Using a commercial participant-locating

or letter forwarding service (such as [www.unclaimedretirementbenefits.com](http://www.unclaimedretirementbenefits.com)) (historically the Department of Labor required use of either the IRS or SSA letter forwarding programs, but both of those programs have been discontinued within the past year – it is a reasonable assumption that Labor will want to see use of a commercially reasonable equivalent in the absence of those programs).

In the event that your plan allows cash-out distributions on terminated participants with account balances under \$1,000, or rollover to IRA for balances between \$1,000 and \$5,000, be sure to check the provisions described in the plan document. Typically a rollover to an IRA on behalf of these participants can be accomplished for participants deemed to be missing. For more information on this topic, please contact your plan consultant.

# ESTABLISHING YOUR RETIREMENT PLAN COMMITTEE CHARTER

As retirement plan consultants we strongly encourage our clients to formally establish a Retirement Plan Committee. The establishment of a Committee may be formalized by adopting a Retirement Plan Committee Charter. This Committee Charter helps to protect the named fiduciary, typically the Board of Directors, by delegating certain identified fiduciary responsibilities to the Committee. It protects the Committee members by defining the specific duties for which they are responsible. Furthermore, it protects the participants as it provides for orderly and prudent governance of the plan designed for the exclusive best interests of the participants and their beneficiaries, as required by ERISA Section 404(a).

Discuss this topic with your plan consultant during your next meeting. He/she can assist the process of adopting a Committee Charter by providing our sample Committee Charter document and helping select the appropriate

provisions. Consider the following discussion points:

- Determine the purpose of the Committee (investment related, administrative issues, or both).
- Determine how Committee members are selected (who should/should not be members).
- Is there an ideal number of Committee members?
- What topics should the Committee cover?

The recent volatility in the stock market combined with our litigious society is generating concern on the part of many fiduciaries regarding their potential exposure. Taking a casual approach to plan governance, without a formalized Committee Charter, will not help insulate the company or the plan fiduciaries from participants' complaints or lawsuits. Please call your plan consultant for more information.



## FEE REASONABLENESS, *continued from page 1*

already active in this area. One firm specializing in fee related fiduciary breach litigation is reported to have already generated \$175M in revenue over the past few years.

Based on off-the-record conversations with DOL representatives it appears they took a "wait and see" attitude during the first year of implementation to assess service provider and plan sponsor reaction. In year two, which began January 1, 2014, the DOL advises to expect increased audits and potential penalties for non-compliance. Some independent auditors have already begun asking questions during the annual plan audit as to how plan sponsors are responding to these regulations and are reporting their findings to the DOL in their annual audit filings.

### **DETERMINE FEE REASONABLENESS**

To make this determination of reasonableness, it is necessary for the plan sponsor to review the 408(b)(2) disclosures provided by plan service providers and develop a clear and demonstrable working knowledge of its plan fees and components.

Defined contribution plan fees fall within three major categories: investment management, administration and

advisory. Pure investment management expense is always paid by the participant and is deducted from investment return. Administrative expense and advisory fees can be shared with or paid by participants, the plan or the company. In many cases all are combined into a single asset based charge. Included in this combined charge may be a revenue sharing component, which should also be reviewed for reasonableness.

### **THE RFP**

A plan sponsor can take the next step, which is to initiate a Request for Proposal (RFP) from competing recordkeeper providers. The process of soliciting and analyzing provider quotes is not a simple task and should be accomplished with the assistance of an expert. This analysis is not as simple as comparing fees and "doing the math". There are many ways a provider can create the illusion of lower cost. Remember the definition of prudence under ERISA is a heightened one of "prudent expert" requiring appropriate and documentable expertise. The DOL's expressed concern is that a non-expert, however well intended, "may not know what they don't know." Also, ERISA's procedural prudence process must be followed, as with all significant fiduciary decisions.

RFP responses must include an explicit and transparent statement of all fees and expenses, any restrictions, all services with contracts and investment assumptions in order for the fiduciary to be able to document an equitable comparison and determination of reasonable expenses.

Investments offered to participants should be predicated on plan goals and participant demographics. Note, the DOL recently provided specific guidance on how target date funds should be selected and monitored. These should not be ignored when undertaking an RFP & benchmarking of plan fees.

**PRUDENT FIDUCIARY ACTION**

As plan fiduciaries review the offers of recordkeepers, they should understand that the DOL made clear that the fiduciary is under no obligation to select the lowest priced provider. Rather, there should be a comparison of services,

investment opportunities and other factors along with price. The general consensus in the ERISA community is that a price should be achieved within the range of the bidders. If an incumbent provider is priced high, they are typically willing to negotiate their fee to achieve fiduciary comfort.

Once this RFP exercise is complete and fee reasonableness and its process is documented, it should be followed up with an annual fee benchmarking. Another full RFP should occur every three to four years, or upon significant growth in assets. Whenever a change in provider is considered, a full RFP should be performed to document competitive comparisons.

An engaged fiduciary working with a quality independent consultant will have no difficulty discharging this important and liability mitigating responsibility.

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**COLLECTIVE INVESTMENT TRUSTS, *continued from page 2***

- **POTENTIALLY LOWER COST TO PARTICIPANTS**  
 - Using collective fund structures to manage model portfolios has allowed many plan sponsors and advisors to drive down asset management costs to their participants.

**WHY EXPENSES ARE TYPICALLY LOWER**

A major reason for the typically lower expenses of collective funds is that individual investors cannot invest in these products. As such, their costs are often well below those of mutual funds, due to their less stringent reporting and administrative requirements.

This provides plan sponsors and their investment advisors an opportunity to use a structure that is dedicated to the retirement plan marketplace, with funds selected to meet the unique needs of such plans.

Of course, collective fund portfolio managers need to account for daily liquidity for participant withdrawals or plan sponsor liquidations. However they do not have to plan

for retail and hedge fund investor behavior.

Collective funds investors are limited to defined contribution, defined benefit and government 401(a) and 457 retirement plans. Collective Investment Trusts are maintained by bank trust companies and maintain an exemption from the 40's act under section 3(c)11.

**SUMMARY**

Collective Investment Trusts are viable investment options to mutual funds, with collective funds typically providing significant cost savings. However, the decision to use a Collective Investment Trust or mutual fund should be decided on a case-by-case basis.

Ultimately the decision to use mutual funds, collective funds, or both, resides with plan sponsors and institutional investment advisors. However, knowledge of collective funds as an alternative to mutual funds can in the right situation produce measurable benefits.



*This article was written by Wilmington Trust and published in RPAG's Spring Summit Magazine, Impact. Minor edits were made for compatibility purposes.*

**COMMUNICATION CORNER: How long will your money last?**

This month's employee memo is titled, "How long will your money last?" The memo helps participants set achievable goals by showing examples of what different account balances will actually provide during retirement.

As a reminder, we post each monthly participant memo online via the Fiduciary Briefcase™ ([fiduciarybriefcase.com](http://fiduciarybriefcase.com)) and it is also available in Spanish.

Call or email your Plan Consultant if you have questions or need assistance.

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To remove yourself from this list, or to add a colleague, please email Brandy Lester at [blester@heritagetrust.com](mailto:blester@heritagetrust.com) or call (405) 608-8660.

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