PLAN FEES & BENCHMARKING

VIRTUS INVESTMENT PARTNERS

A Primer for Retirement Professionals

RETIREMENT SOLUTIONS

EXECUTIVE SUMMARY

As a consumer, whether you are buying a product or contracting for services, you want to make sure you receive value for the price you pay. Common sense tells you not to pay excessive fees when more cost-effective options are available. Employers who sponsor a retirement plan also seek high-value services and investment products for the fees they are paying. For plan sponsors, however, this is more than just common sense. It is a legal responsibility—and one that is currently under intense scrutiny.

Today's focus on plan fees is driven by **two separate but powerful influences**:

1. **Fee disclosure regulations** – The U.S. Department of Labor (DOL) requires plan sponsors to collect and analyze service provider fee disclosures before entering into a service arrangement.[1] To fulfill this important mandate, plan sponsors need to benchmark fees to make sure the fees are reasonable compared to comparable alternatives.
2. **Fee litigation** – A rapidly growing volume of class action lawsuits by participants claiming plan fiduciaries paid excessive fees for investments and services has resulted in large judgments and settlements against plan sponsors.

Most plan sponsors understand that fees for investments and plan services must be "reasonable." But they face significant challenges in determining whether their plan's fees are reasonable. As a consumer, you have the ability to compare costs by simply looking at similar products on the shelf or by comparing the fees for the same product charged by different stores or online retailers. For plan sponsors, the process is far more complicated. Some of the barriers they face in conducting this type of cost comparison include:

- Complex fee structures that vary among different types of investments and among share classes
- A wide variety of administrative service models and fee schedules
- The common use of revenue sharing arrangements to cover the cost of certain services
- Lack of direct access to meaningful price comparison tools to benchmark fee reasonableness

Plan sponsors need your expertise, as a retirement professional, to understand and manage plan fees. In addition to educating plan sponsors about their Employee Retirement Income Security Act (ERISA) fiduciary responsibilities to evaluate and monitor plan fees, you can help them build a due diligence process that will create a disciplined approach to evaluating and documenting service provider and investment decisions. You can also serve as a gateway to benchmarking resources that will give plan sponsors the cost comparisons they need to ensure fees are reasonable.

Virtus developed this primer to help you make fee analysis and benchmarking a premier component of your service model. In addition to providing a review of the regulatory framework for plan sponsor fee-related responsibilities, it introduces possible components for a benchmarking strategy that will help you deliver this highly valued support to plan fiduciaries.

[1] Department of Labor Regulation 2550.408b-2, Reasonable Contract or Arrangement Under Section 408(b)(2), 2012

SECTION 1:
FEE-RELATED RULES & TRENDS

As ERISA fiduciaries, plan sponsors are held to high standards of conduct when dealing with retirement plans. Their actions must be prudent and in the best interest of the plan and its participants. They must also make certain that fees paid by the plan or plan participants are reasonable.[2] Paying unreasonable fees from plan assets may result in a breach of their fiduciary duties. If a fiduciary does not fulfill its fiduciary obligations, participants and other plan fiduciaries have the right to initiate lawsuits to correct fiduciary wrongdoing. The DOL also has the authority to enforce the rules through civil and criminal actions.

Sources of Plan Fees

While most plan sponsors understand that managing plan fees is an important fiduciary mandate, the task is far more complicated than the cost comparisons you typically face in your day-to-day life as a consumer. Retirement plans are a complex savings vehicle and require the support of multiple service providers—retirement professionals, recordkeepers, trustees, accountants—all of whom charge fees for their services. Fees for plan investments comprise the largest portion of the fees paid by a plan. Additional fees may be incurred for consultative services to the plan sponsor, such as tax planning or plan corrections.

Types of Plan Fees

Three types of fees are associated with participant-directed defined contribution plans		
INVESTMENT FEES	**ADMINISTRATIVE FEES**	**SETTLOR FEES**
Fees charged by investment providers	Fees assessed for ongoing management of plan	Fees for services that primarily benefit the plan sponsor
– Investment management – Sales charges – 12b-1 fees – Service provider revenue sharing	– Recordkeeping – Trustee services – Transaction fees	– Tax consulting – Legal fees related to plan establishment or termination decisions – Plan design proposals – Correcting compliance or fiduciary errors
Must be paid: – Indirectly via investments – Cannot be paid by plan sponsor or participants	May be paid by: – Plan sponsor – Plan assets (e.g., participant accounts) – Revenue sharing	Must be paid by: – Plan sponsor

[2] ERISA Section 404(a)

Heightened Focus on Plan Fees

Two recent developments serve to drive home to plan sponsors the importance and the difficulties associated with managing plan fees.

Fee Disclosure Regulations – In 2012, the DOL released its ERISA 408(b)(2) service provider fee disclosure regulations. These rules are designed to ensure that plan fiduciaries receive the information needed to assess the service provider contract or arrangement and identify potential conflicts of interest before entering into a service relationship. The regulations also provided an important reminder to plan sponsors of their fee oversight responsibilities and the potential for DOL enforcement for noncompliance. It is anticipated that these regulations will be a significant DOL enforcement focus. One of the DOL's current enforcement initiatives is the Plan Investments Conflicts project, which focuses on service provider compensation, excessive fees, fee disclosures, and conflicts of interest.[3]

The transparency of fees provided by service provider disclosures enables plan sponsors to understand what fees the plan is paying for services. However, as we'll cover, benchmarking support provided by retirement professionals is needed to determine whether those fees are reasonable.

Fee Litigation – The rapidly growing volume of participant class action lawsuits claiming excessive fees is also driving a heightened awareness of plan fees. A number of recent lawsuits allege a breach of fiduciary duty resulting from payment of unreasonable fees for investments or administrative services, such as choosing investments with high fees when lower cost alternatives were available, and not monitoring the impact of revenue sharing.[5] The large judgments and settlement amounts in some cases serve to illustrate the value of fee monitoring and benchmarking support services.[5] One of the most important messages emerging from the lawsuits is the fiduciary mandate to follow a well-defined due diligence process for evaluating plan fees.

REVENUE SHARING REFRESHER

One of the variables that can add to a plan sponsor's confusion regarding fees is the use of revenue sharing arrangements. Most often these arrangements involve investment providers making payments to other plan service providers in exchange for product distribution or administrative services that the investment provider would otherwise have to perform themselves. In some cases, revenue sharing payments are used to directly offset plan administrative expenses, while in others they are deposited into "ERISA accounts" and used to pay various plan expenses, as directed by the plan sponsor. The DOL has made clear that it is the fiduciary's responsibility to analyze the impact of revenue sharing on plan fees.[4] Most plan sponsors rely on their retirement professionals to help them analyze revenue sharing arrangements and their impact on plan fees.

[3] DOL National Enforcement Projects, DOL Enforcement web page, September 2018, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement#national-enforcement-projects

[4] DOL Advisory Opinion 2013-3A, July 3, 2013

[5] Abbott v Lockheed Martin Corp., Nos. 12-8037, 12-3736 (7th Cir. Filed 11/30/2012); Tibble v. Edison International, 711 F.3d 1061 (9th Cir. 2013); Tussey v. ABB, Inc., No. 12-2056, 2014 WL 1044831 (8th Cir. 3/19/14); Kruger v. Novant Health, Inc., 1:14-cv-208 (M.D.N.C. filed 3/12/14); Lorenz v. Safeway, Inc., No. 4:16-cv-04903 (N.D. Cal. filed 8/25/16), Cates, et al. v. Trustees of Columbia University, et al. 1:16-cv-06524 (S.D.N.Y. filed 8/17/2016); Vellali, et al. v. Yale University, et al. 3:16-cv-01345 (D. Conn. 2016); Daugherty v. Univ. of Chicago, No. 1:17-cv-03736 (N.D. Ill. filed 5/18/2017)

Growing Fee Complexity

At the same time the focus on fee oversight has become more intense, the complexity of fee arrangements has been on the rise. In recent years, there has been a significant increase in the number and variety of investment options available to retirement plans. For example, not only do fee arrangements vary among different types of investments (e.g., mutual funds, annuities) and among investments with similar objectives and features available from different money managers, fees can also vary significantly among share classes within a single fund. A single mutual fund may have share classes that include revenue sharing and other share classes that do not, making the plan sponsor's responsibilities even more challenging.

SECTION 2:

BUILDING A FEE BENCHMARKING STRATEGY

One of the most valuable services you can provide as a retirement professional is to help plan sponsors develop a process for collecting fee information and benchmarking those fees against comparable investments and service providers. Plan sponsors may not have access to the tools or data needed to compare their plan's fees against similar plans. In addition to providing critical information about fees, you have the skills to help plan fiduciaries weigh a plan's costs against other factors that should be considered when selecting investments or services.

Benchmarking is a critical step in any fee due diligence process.

Position Your Benchmarking Services

To Prospective Clients – Introducing your benchmarking services creates an opportunity to illustrate the depth of your industry knowledge and the scope of fiduciary compliance support you can deliver.

To Existing Clients – In addition to helping plan sponsors meet their fiduciary obligation to monitor plan fees, periodic benchmarking reviews provide an opportunity to strengthen your relationship and to identify strategies to enhance plan performance.

Benchmarking Scope of Services

1 Educate Plan Sponsors

As you discuss plan fees with plan sponsor clients and prospective clients, you may find that some lack a clear understanding of their ERISA fiduciary responsibilities regarding fee oversight. It is important for plan sponsors to know that although you can provide valuable support, the ultimate responsibility and potential liability for ensuring fees are reasonable falls on the plan sponsor. Delivering basic fiduciary education and an overview of the DOL service provider disclosure rules may provide a solid foundation for your fee-based support services. As part of its fiduciary education campaign, "Getting It Right—Know Your Fiduciary Responsibilities," the DOL provides a library of publications and tools that retirement professionals can tap into to deliver education, accessible via the DOL website (dol.gov).

2 Introduce a Due Diligence Process

Helping plan sponsors design a process for analyzing fees and complying with the service provider disclosure regulations creates another valued service opportunity. Most plan sponsors need the expertise of their retirement professional to help them create a framework or checklists to collect fee information and then analyze that information.

3 Build an Effective, Scalable Strategy

Benchmarking is a critical step in any fee due diligence process. To make fee analysis a premier component of your service model, you must be able to perform benchmarking efficiently—to make the service scalable—while at the same time be able to address the unique objectives and needs of each client.

Find an Effective Benchmarking Tool

A number of benchmarking tools are available in the marketplace for retirement professionals to use. As you evaluate the options, consider these questions:

- Is the tool easy to use, with straightforward navigation?
- What information will you need to enter to create a meaningful benchmarking report?
- Will the report output meet your needs (e.g., depth of information, readable format, ability to customize)?

While benchmarking was once viewed strictly as a process for comparing investment alternatives, some of today's benchmarking tools also enable you to evaluate the plan's recordkeeping and administrative services and participant retirement savings success metrics.

Make Meaningful Comparisons

As you develop your benchmarking process, consider the following details to ensure that your fee analysis is effective and relevant.

Identify the plan's peers – Identifying the correct peer group is critical to providing useful benchmarking data. Fees can vary significantly based on plan size, with larger plans generally paying a lower fee, calculated as a percentage of plan assets. Benchmarking within a client's industry will also help determine whether the plan is competitive in the marketplace.

Assess comparable services – The scope of services provided can vary significantly among service providers. For example, to accurately compare recordkeeping fees, it is important to identify fees paid from all sources (e.g., participant accounts, plan sponsor, revenue sharing). Participant fee disclosures can provide information regarding recordkeeping fees paid through revenue sharing.

Collect accurate data – The validity of the benchmarking results is, of course, dependent on the accuracy of the data obtained. Much of the fee information needed for benchmarking tool data points, including plan size and industry, can be found on a plan's Form 5500, Annual Return/Report of Employee Benefit Plan. Forms 5500 are accessible to the public via the DOL website (dol.gov).

Use a reliable database – Make certain the benchmarking tool you use has dependable data for comparing plan fees. Benchmarking databases that contain information collected directly from service providers (e.g., recordkeepers, retirement professionals) may be more reliable than a database based on surveys. It is also important to ascertain that the number of plans represented is sufficiently large to provide an appropriate comparison of similar size plans. You should also confirm that the database is updated on a regular basis so that it reflects changes in plan trends.

An Effective Presentation & Next Steps

As you prepare to review your benchmarking report with the plan sponsor, consider if there are any related issues that should be discussed to add context to the report (e.g., the plan sponsor's ERISA fiduciary obligation to benchmark fees, the plan sponsor's plan objectives).

In addition to presenting the report findings to the plan sponsor, prepare a list of potential action steps that you want to discuss. Some possible steps include:

- Delivering plan sponsor fiduciary education
- Helping the plan sponsor refine the plan's due diligence process for monitoring plan fees
- Exploring new service providers or new service models
- Setting and measuring participant success metrics
- Adjusting plan design to drive stronger participant savings outcomes
- Building and executing a participant education or communications strategy
- Setting a schedule for future benchmarking assessments

Economic conditions, investment alternatives, and service offerings change over time. It is critical that plan benchmarking be conducted on a periodic basis. Ongoing monitoring and due diligence is critical in meeting fiduciary responsibilities.

As always with ERISA requirements, documentation is key. Plan sponsors need to be able to demonstrate they follow a prudent process in analyzing plan fees. They should keep copies of the benchmarking reports with other plan documentation, such as meeting minutes reflecting critical plan decisions.

To learn more about the retirement resources available from Virtus, visit **virtus.com/DCIO**.