



Benchmarking Plan Fees

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Session Description

Learn when and how much a fiduciary or adviser should rely upon fee Benchmarking statistics to support a prudent process. Over reliance on fee benchmarking statistics can cause an engagement to become unreasonable and unreasonable fees can be disgorged. Learn when an adviser is vulnerable to a claim for unreasonable fees when using fee benchmarking to justify existing fee agreements. Also learn what steps can be taken to support and defend a prudent process when fee benchmarking is used and how plan demographics and asset size impacts a plan sponsor or adviser's ability to prevail when challenged.

AGENDA

1. Defining Benchmarking
2. Benchmarking Challenges
3. Expenses MUST be Permissible & Reasonable
4. Reporting and Disclosure of Expenses
5. An Example: Fiduciary Benchmarks
6. Conclusions

1. Defined

The term benchmarking was first used by cobblers to measure ones feet for shoes. They would place the foot on a "bench" and mark to make the pattern for the shoes.

Benchmarking is the process of comparing the cost, cycle time, productivity, or quality of a specific process or method to another **that is widely considered to be an industry standard** or best practice. The result is often a business case for making changes in order to make improvements.

2. Challenges

1. Societal attitude that everyone is a winner
2. Failure to obtain Comprehensive Information
 - a) Consideration of Discounts for multiple services
 - b) Tying specific Services to a specific Fee

NOTE: Total Plan Cost Comparisons "FAIL" to support Procedural Prudence!
3. Ability to unravel fees buried in Expense Ratios
NOTE: Ultimately, there are "NO" 401(k) plan quotes based purely on total cost!
4. There is "NO" industry-wide accepted benchmarking standard(s)

3. Expenses MUST be Permissible & Reasonable

- **29 C.F.R. § 2550.408b-2(a)** Section 408(b)(2)...exempts from the prohibitions of section 408(a)... payment by a plan...for...any service...if...no more than reasonable compensation is paid for such office space or service.
- **29 C.F.R. § 2550.408b-2(d)** Section 408(b)(2) of the Act and Sec. 2550.408b-2(a)(3) permit a plan to pay a party in interest reasonable compensation for the provision of...services described in section 408(b)(2).

4. Reporting & Disclosure of Expenses

- Do the Reporting & Disclosure requirements under Title I impose an obligation to report expenses by services rendered?
 - Schedule C – Service Provider Information
 - Must reflect direct or indirect compensation paid to "any" service provider of \$5,000 or more
 - Indirect compensation includes compensation paid by the plan sponsor which is later reimbursed by the plan. It also includes the **payment of finder's fees or other fee and commissions**, other than those reported on Schedule A, by a service provider or an independent agent or employee **for a transaction or service involving the plan**. Brokerage commission should be included only if the broker is granted some discretion with regard to the management of plan investments. [DOL Reg. 2510.3-21(d)(2)]

4. Reporting & Disclosure of Expenses

There are twenty-three (23) Plan Service Codes (a/o 2008) to identify services rendered. Some of those include:

- 13 – Administration
- 17 – Consulting
- 19 – Insurance Agents & Brokers
- 20 – Investment Advisory
- 21 – Investment Management
- 24 – Recordkeeping
- 29 – Investment evaluations
- 99 - **Other**

According to the DOL - WHAT, WHEN & HOW

- "Fundamental to a fiduciary's ability to discharge these obligations (i.e. "to act prudently and solely in the interest of the plan's participants for the exclusive purpose of providing benefits and defraying reasonable expenses") is the availability of information sufficient to enable the fiduciary to make informed decisions about the services, the costs, and the service providers." [See 70988 A. Background, (1) General (Dec 13, 2007)]
- "The Department believes that in order to satisfy their ERISA obligation, plan fiduciaries need information concerning all compensation to be received by the services provider and any conflicts of interest that may adversely affect the service providers' performance under the contract or arrangement." [See 70989 A. Background, (2) The Statutory Exemption for Services (Dec 13, 2007)]

According to the DOL - WHAT, WHEN & HOW

- "Further, the responsible plan fiduciary, consistent with its general fiduciary obligations under ERISA, must ensure in its negotiations with a service provider that he or she obtains current and accurate information from the service provider sufficiently in advance of entering into the contract or arrangement to allow the fiduciary to prudently consider the information." [See 70990 B. Proposed Amendment to Regulations Under ERISA Section 408(b)(2); (b) Disclosure Concerning Compensation and Services (Dec 13, 2007)]
- Section 404(a) of ERISA requires that the responsible plan fiduciary engage in an objective process designed to elicit information necessary to assess not only the reasonableness of the compensation or fees to be paid for services, but also the qualification of the service provider and the quality of the service that will be provided. [See 70993 B. Proposed Amendment to Regulations Under ERISA Section 408(b)(2); (f) Compliance by Service Providers (Dec 13, 2007)]

According to the DOL - WHAT, WHEN & HOW (Cont.)

- [w]hen selecting or monitoring service providers, plan fiduciaries must act prudently and solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan. To meet these obligations, it is vital that fiduciaries have enough information to make informed assessments and decisions about the services, the costs and the providers. In this regard, the Department has published interpretive guidance concerning the disclosure and other obligations of plan fiduciaries and service providers under sections 404, 406(b) and 408(b) of ERISA. [See 70995 E. Regulatory Impact Analysis; (3) Need for Regulatory Action (Dec 13, 2007)]

According to the DOL - WHAT, WHEN & HOW (Cont.)

- According to the fiduciary duty prescribed under the current regulatory framework, a fiduciary "must obtain information about fees and conflicts of interest." [See 70995/ Vol. 72, No. 239, E. Regulatory Impact Analysis, (4) Regulatory Alternatives (Dec 13, 2007)]
- Plan fiduciaries already have a fiduciary duty to evaluate the reasonableness of offers from service providers, and they already have access to tools like the Model Plan Fee Disclosure Form to assist them in asking service providers questions in order to encourage disclosure. [See 71000 E. Regulatory Impact Analysis; (7) Costs - (c) Costs to Plans (Dec 13, 2007)]

Questions to Consider

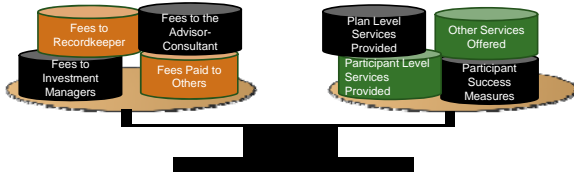
- How do you know expenses are reasonable unless you can assess the cost by services rendered?
- Is a fiduciary acting solely in the best interest of the participant if the fiduciary can not identify fees by services rendered?
- Is a disproportionate allocation of the expenses among participants prudent and in the best interests of the participants?
- What should the Employer disclose to participants in a plan that intends to comply with section 404(c).

Field Assistant Bulletin 2003-3 (May 19, 2003) "On the other hand, if a method of allocation has no reasonable relationship to the services furnished or available to an individual account, a case might be made that the fiduciary breached his fiduciary duties to act prudently and "solely in the interest of participants" in selecting the allocation method."

5. An example: Fiduciary Benchmarks

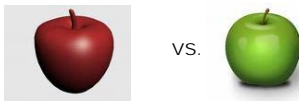
What the Plan Pays

What the Plan RECEIVES



- The DOL has clearly stated that fees are important, but that they are not everything.
- Plan sponsors must understand and account for all plan fees.
- Those fees should be reasonable for the quantity and quality of services being provided.

Step 1: Determine the Benchmark Group



Quality of Comparisons

Benchmark Group Factor	Fee Impact	Value Impact
Plan Assets	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Number of Participants	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Last year plan was "put out to bid"	<input checked="" type="checkbox"/>	
Industry	<input checked="" type="checkbox"/>	
Plan Type	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Uses Auto-Enrollment	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Maximum Employer Match	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
% of assets in index funds	<input checked="" type="checkbox"/>	
% of assets in Managed Accounts	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>

Quantity of Comparisons

How many comparisons are needed?

- 5-6?
- 10-15?
- 20-25?
- 200?

The answer is best determined by looking at the available data and the variances in the underlying factors and using statistical analysis to determine the number of data points needed

Step 4: Consider the ultimate customer - participants

SAVING

- What is the plan's current participation rate?
- Are participants maximizing the employer match?
- What is the average deferral rate for higher-pay employees?
- What is the average deferral rate for lower-pay employees?
- Are participants making "catch-up" contributions?

INVESTING

- What percentage of plan assets are in auto-diversified choices?
- Are participants using the plan's advice programs?
- What percentage of plan assets are invested using advice?
- Are participants using the plan's auto-rebalance option?

SPENDING

- Are terminated participants "cashing out" instead of rolling over or staying in the plan?

PLANNING

- How many participants have a personal retirement goal?
- Are participants on track to achieve that goal?

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Step 5: Plan Sponsor Services – a partial list of how advisors help plan sponsors

Plan Design

- Auto-Enroll provisions
- Auto-Escalate provisions
- Employer contribution provision
- Annuity distribution option

Investments

- Number of Investment choices
- Target Based Funds
- Self Directed Brokerage
- Managed Accounts

Administration

- Building the SLA
- Monitor recordkeeper
- Conducting search

Communications

- Setting participation goals
- Setting investment goals
- Conducting employee meetings

• Plus, if your client has company stock this poses an additional set of responsibilities you will need to provide your clients

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Step 6: Participant Services

Participant Communication Services

- Customized versus Branded versus standard materials
- Customized Campaigns
- Annual Benefit Statements/Projections

Participant Administration Services

- Number of Payrolls processed
- QDROs approved and processed
- Approves hardship withdrawals

Service Standards

- Processing Errors
- Processing Speed of Payroll Tapes and Distributions
- Speed of Answering the Phones

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6. Conclusions

- 1. Procedural Prudence demands Component Pricing
 - a. If an Adviser can do it so can other Service Providers
- 2. Each Component must be Reasonable
- 3. Unreasonable Fees are subject to disgorgement and excise tax
- 4. Pricing below the Mean, Median or Average may not be Reasonable



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