



**FOCUS ON
PLAN FEES & BENCHMARKING**

A Guide for Financial Advisors

FOCUS ON PLAN FEES & BENCHMARKING: A GUIDE FOR FINANCIAL ADVISORS

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** – Department of Labor (DOL) fee disclosure regulations require plan sponsors to collect and analyze service provider fee disclosures before entering into a service arrangement.¹ To fulfill this important mandate under these DOL regulations, 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 the 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

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

Plan sponsors need your expertise, as a financial advisor, 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 **Focus on Plan Fees & Benchmarking: A Guide for Financial Advisors** (the Guide) 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, the Guide introduces possible components for a benchmarking strategy that will help you deliver this highly valued support to plan fiduciaries.

Plan sponsors need your expertise, as a financial advisor, to understand and manage plan fees.

SECTION 1: FEE-RELATED RULES & TRENDS

As ERISA fiduciaries, plan sponsors are held to high standards of conduct when dealing with their retirement plans. Their actions must be prudent and in the best interest of their 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.

² ERISA Section 404(a)

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—advisors, 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.

A PRIMER ON PLAN FEES

Three types of fees commonly arise in 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
<ul style="list-style-type: none"> • Investment management • Sales charges • 12b-1 fees • Service provider revenue sharing 	<ul style="list-style-type: none"> • Recordkeeping • Trustee services • Transaction fees 	<ul style="list-style-type: none"> • Tax consulting • Legal fees related to plan establishment or termination decisions • Plan design proposals • Correcting compliance or fiduciary errors
Must be paid: <ul style="list-style-type: none"> • Indirectly via investments • Cannot be paid by plan sponsor or participants 	May be paid by: <ul style="list-style-type: none"> • Plan sponsor • Plan assets (e.g., participant accounts) • Revenue sharing 	Must be paid by: <ul style="list-style-type: none"> • Plan sponsor

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 they need 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 is the first step in enabling plan sponsors to understand what fees the plan is paying for services. As we discuss in the Guide, however, benchmarking support provided by financial advisors is needed to determine whether those fees are reasonable.

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 these revenue sharing payments are used to directly offset plan administrative expenses while in others they are deposited into "ERISA accounts" and then 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 financial advisors to help them analyze revenue sharing arrangements and their impact on plan fees.

³ DOL National Enforcement Projects, DOL Enforcement web page, November 2016, <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement>

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

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, including choosing investments with high fees when lower cost alternatives were available, not monitoring the impact of revenue sharing, and paying unreasonable administrative fees.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.

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 pay none, 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 an advisor is to help plan sponsors design a process for collecting fee information and benchmarking those fees against comparable investments and service providers. Without your support, plan sponsors do not have access to the tools or data needed to benchmark their plan fees against other providers. In addition to providing critical information about fees, you have the skills to help plan fiduciaries weigh the fees against other elements that should be considered when selecting investments or services.

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

⁵Abbott 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 08/25/16)

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 as the plan’s advisor.

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 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 understand 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, the DOL provides a library of publications and tools that advisors can tap into to deliver education, such as the publication *Getting it Right – Know Your Fiduciary Responsibilities*, 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 financial advisor 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 being able to address the unique objectives and needs of each client. Following are some components of a successful benchmarking strategy.

FIND AN EFFECTIVE BENCHMARKING TOOL

There are a number of benchmarking tools available in the marketplace that are designed for advisors. As you evaluate the various options:

- Look for a tool that is relatively easy to use, with straight forward navigation.
- Evaluate the list of information needed to enter to create a meaningful benchmarking report.
- Review the report output to confirm that it meets your needs (e.g., depth of information, readable format, ability to customize with your logo).

While benchmarking has often been thought of as strictly a strategy 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.

MEANINGFUL COMPARISONS

As you design your benchmarking process, consider the following steps to make certain your fee analysis is delivering a meaningful comparison.

Identify the plan's peers – Identifying the correct peer group is critical to providing meaningful 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.

Compare 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 entering accurate data. 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 has a reliable underlying database for comparing plan fees. For example, some databases contain information collected directly from service providers (e.g., recordkeepers, advisors), which may be more reliable than a database based on surveys. It is also important to make certain the number of plans represented in the database is sufficiently large to provide a meaningful comparison for plans of similar size. 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 the report with a plan sponsor, consider if there are any complementary issues that should be discussed that may create a context for the benchmarking report (e.g., plan sponsor's ERISA fiduciary obligation to benchmark fees, the plan sponsor's plan objectives).

In addition to discussing the outcome of the report with the plan sponsor, prepare a list of potential action steps that you will want to introduce. 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

Economic conditions, investment alternatives, and service offerings change over time. It is critical that 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.

VIRTUS BENCHMARKING SUPPORT

First introduced on the heels of the DOL's 2012 service provider fee disclosure regulations, the Fee Comparison Tool enables advisors to provide the benchmarking data their plan sponsor clients need to fulfill their fiduciary mandates under ERISA and DOL regulations. Virtus helps keep advisors abreast of fee-related trends and marketplace changes through updates to the database supporting the Fee Comparison Tool.

Key features set Virtus' Fee Comparison Tool apart from other benchmarking tools:



Simple & Intuitive Navigation – Easy to use, ability to create meaningful benchmarking reports with minimal data



Broad Variables – Ability to benchmark a broad range of investment and recordkeeping fees as well as critical participant success metrics



Robust, Reliable Database – Large database built on information collected from plan service providers, updated quarterly



Advisor Customization – Ability to select the investment and plan features to benchmark, and customize reports with the advisor's logo



Complimentary – No licensing or report generation fees (up to five reports per quarter)

The database underlying the Fee Comparison Tool is provided by Fiduciary Benchmarks, an independent company that provides benchmarking data and services. Characteristics of the database that make it uniquely suited to retirement plan benchmarking include its:

- **Reliability** – contains information collected directly from service providers (e.g., recordkeepers, advisors) rather than pulling data from Form 5500 or collecting information through surveys
- **Large size** – includes data on more than 100,000 plans
- **Frequent updates** – reflects changes in plan trends through quarterly updates

The information Virtus provides in its benchmarking report will help plan sponsors put fees into perspective and provide the documentation plan sponsors need to demonstrate fiduciary due diligence.

To learn more about the Fee Comparison Tool or other advisor resources available from Virtus, visit [planadvisortools.com](https://www.planadvisortools.com).



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