Analyze This

Cost benefit analysis requires a long view

WHEN plan sponsors evaluate the costs of services, the first step is to compare the cost of similar services offered by competing providers. The next step is to compare the cost to the value of the services. If a service significantly improves the plan, it is money well-spent. It passes the cost-benefit test.

When the Department of Labor (DoL) issues a new regulation, it goes through a similar analysis. It often starts by soliciting input about the particular issue. The DoL then issues a proposed regulation, which is followed by a comment period. After reviewing the comments, the DoL issues a final regulation.

When plan providers submit comments, they often object that compliance with the proposed requirements will increase their costs, and that they will pass that expense on to plans and, therefore, to participants. In essence, the argument is that the new requirements will increase the cost to participants more than the changes will benefit the participants.

The DoL often describes the comments in the preamble to the final regulation. In the preamble to another regulation, the DoL explained:

A number of other commentators commented on the general issues of costs associated with the proposal's requirements....While some indicated that they expected no additional costs or that any additional costs would be negligible or not unduly high, others stated that...[the] requirement would impose significant or high additional costs....One of these commentators estimated that...[it] would increase administrative costs by approximately 200 percent to 250 percent. Others projected increases of varying amounts....

In that case, the DoL concluded that the benefit justified the cost.

As mentioned earlier, a few commentators stated that adding additional investment alternatives would be costly. Further, several others indicated that plans needing to add investment alternatives to their plans will incur some additional administrative expense in connection with selection of managers, recordkeeping, monitoring the experience of the added alternatives and effecting transfers. One commentator estimated the additional costs associated with the establishment and maintenance of one additional investment alternative to be approximately 15 percent of the plan's administrative costs for a typical plan....

As you read the quoted language, you may have wondered about the regulation that accompanied this preamble. In fact, if you re-read the quote earlier in this column, you might also ask what would have increased administrative costs by 200% to 250%.

I admit it; I played a trick on you. Both quotes are about 20 years old. They are from the preamble for the final 404(c) regulation. The DoL was explaining, first, that some commentators felt that, if you had to allow participants to trade quarterly, rather than annually, it would increase administrative costs by 200% to 250%. In the second quote, commentators were objecting to the requirement that 401(k) plans have at least three investment alternatives. The objection was that the addition of the second and/or third investment alternative would increase expenses and thereby reduce retirement benefits.

We now know that, in both cases, the commentators were short-sighted in their analyses. They could see the additional expense of complying with the new 404(c) regulation. However, they could not foresee the benefits of a robust lineup of investments together with comprehensive information about the investments.

Most of us do not want to be burdened by more rules. However, new guidance needs to be evaluated through a cost-benefit analysis over the long term. The message to both the DoL and fiduciaries is that they need to focus more on the long-term issues for improving retirement benefits and less on short-term cost—so long as the long-term value is there.

Fred Reish is Managing Director and Partner of the Los Angeles-based law firm of Reish & Reicher. A nationally recognized expert in employee benefits law, he has written four books and many articles on ERISA, IRS and DoL audits, and pension plan disputes. Fred has been awarded the *Institutional Investor* Lifetime Achievement Award and *PLANSPONSOR*'s Lifetime Achievement Award. He is also one of the 15 individuals named by *PLANSPONSOR* magazine as "Legends of the Retirement Industry."