



Growth Is Good and Less Expensive

If you don't ask, you won't know

THERE is a responsibility under ERISA for fiduciaries to evaluate whether arrangements with service providers are reasonable. That responsibility is found in the fiduciary responsibility rules of ERISA §404(a) and the prohibited transaction provisions in §408(b)(2). The responsibility includes assessing the reasonableness of the fees being paid to advisers, the revenues received by recordkeepers and third-party administrators, and the expenses of the investments.

In testimony before the Department of Labor (DoL) Advisory Council in 2007, the Investment Company Institute (ICI) described several options that plan sponsors have for reducing the costs and fees (the ICI is the organization that represents the interests of mutual fund managers):

“[T]he plan fiduciary and service provider have a number of options. One is to lower total plan costs by replacing existing plan investments with lower-cost options or share classes. Another is to provide the plan and participants with additional services that were not originally affordable. For example, as a new plan grows, it may become possible to provide participants with access to investment advice. A third option for plan fiduciaries might be to negotiate with the recordkeeper to share some of the recordkeeper’s revenue with the plan. Finally, the plan fiduciary can put the service contract out for bid to determine whether other service providers might offer comparable services at a lower cost. According to one recent study, plan sponsors, on average, evaluate their recordkeeper about every four years.”

How do you know if the fees are excessive? The best way is through an RFP process; that is, send requests for proposals to the providers that serve plans your size. While that is the most effective way to price your plan, it is time-consuming and involves some cost. Another way is to benchmark your plan against plans of similar size and characteristics. The key criteria are total assets in the plan, number of participants, and industry of the plan sponsor.

A recordkeeper often is paid by direct payments from plan assets (e.g., base fees), transaction fees from participants (e.g., loan and distribution fees), and indirect payments, or revenue sharing, from mutual funds. Small plans commonly pay the recordkeeper in all three ways. As a plan grows, however, the

revenue sharing usually grows faster than the cost of record-keeping. As a result, attentive fiduciaries are able to get recordkeepers to absorb some or all of the costs that were previously paid by the plan.

Fiduciaries need to consider two kinds of revenue sharing: external payments and internal credits. When the mutual funds are not related to the recordkeeper, they make cash payments to the recordkeeper called sub-transfer agency fees or administrative service fees. However, when the mutual fund management company is an affiliate of the recordkeeper (so-called “proprietary funds”), the recordkeeper may receive internal “credits.” No cash changes hands; it’s just an internal subsidy of the recordkeeper because of the profits made on the proprietary funds. Either way, payments or credits, they are subsidies for the recordkeeper and should be used to reduce the charges for those services. Of course, if you don’t ask, you won’t know, but you won’t ask if you don’t know. (In the recent *Edison International* decision, the judge created a “duty to ask.”)

What should fiduciaries do when the revenue sharing from the mutual funds exceeds the reasonable cost of recordkeeping?

As the ICI explained, you should “negotiate with the recordkeeper to share some of the recordkeeper’s revenue with the plan.” The recovered money should be used to pay reasonable plan expenses and/or should be allocated to the participants’ accounts.

Since fiduciaries have a legal duty to pay no more than reasonable compensation, and since there is a duty to ask, the failure to take any steps may be found to be a fiduciary breach, subjecting plan sponsors and committee members to liability for the excess payments.

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