



Being Reasonable About Plan Expenses

IT IS COMMONLY known that plan sponsors—and their committees—can only pay reasonable amounts from retirement plan assets. How does the committee know whether a particular expense is reasonable or not? There is a two-part test: Part 1 is *qualitative* and part 2 is *quantitative*.

The *qualitative* test is the more difficult. It is a measurement of the value of the service to the particular plan. In other words, a service provided to a plan may be valuable because of the needs of the participants and the effectiveness of the services. To measure the value, a committee needs to look at the results. For example, if a plan provides investment education to the participants, the committee should review participant investment data before the education and then look at the data afterward. If the education services are not moving the needle, the committee should question whether to continue to spend the participants' money (that is, plan money) to support that service. Realistically, though, it is difficult for the committee to obtain that information on its own. As a result, the committee should require that providers baseline the existing conditions, establish benchmarks for improvement, and provide data on the changes and results.

The second test—*quantitative*—is easier to manage. That is partially due to the fact that we now have a significant amount of industry data about the costs of plan services. In other words, plan sponsors can *benchmark* the plan's expenses against a documented standard. The key to successful benchmarking is to make sure that the benchmark is based on a peer group of providers. The primary factors for determining an appropriate peer group are total assets in the plan, number of participants, and industry of the plan sponsor.

Once the peer group's benchmark is determined, the committee should compare it with the cost of the service to the plan.

However, that begs the question: How do you compare your expenses against the benchmark? For example, a benchmark may have data from 30 or 50 plans, or more. In other words, benchmarking data is not a single dollar amount. Rather, it is a range of amounts. Many people believe that the average of the range is the appropriate measurement. I disagree. Instead, I view the analysis as being more like a scattergram. Where there is a concentration of expenses, it is likely that

any number within that concentrated range is reasonable. That is because the marketplace is effective at determining the reasonableness of prices, particularly when the pricing of competing providers is transparent. Stated in another way, there is a *range of reasonableness*.

In a 2007 federal District Court case, the judge reviewed the testimony of the expert for the defendant and, based on that testimony, found in favor of the defendants. The judge summarized the expert's testimony:

The lesson is to benchmark your plan's services against appropriate peer-group data.

"Since a 'median fee is only a middle number of all those that were tabulated,' paying a fee that is above the median does not imply, or even suggest, that it is unreasonable, but only that it is greater than half of the numbers tabulated....It was [the expert's] opinion that a fee that fell between the 25th

percentile and the 75th percentile of all fees paid for that type of investment was 'certainly reasonable.'"

The lesson is to benchmark your plan's services against appropriate peer-group data. It would be difficult for a plaintiff's attorney to show that you were imprudent if you take that step and if the results are reasonable. If the benchmarking shows that your plan is paying unreasonable expenses, then you need to make changes.

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