Retirement Plan Fees Worsen Enterprise Risk

A Management Briefing

ROLAND | CRISS

Contents

Background

Enterprises that sponsor retirement plans are required to protect their employees from paying excessive compensation to vendors that serve their 401(k) and 403(b) type plans. Failure to do so is a breach of their fiduciary duty and a violation of the Employee Retirement Income Security Act (“ERISA”). Complaints about excessive vendors’ fees are high on the list of reasons that employees file complaints against their employers with the U.S. Department of Labor.

A new era of employee activism is underway in which plaintiff lawyers find fertile ground for litigation opportunities, catching many employers unprepared. The focal point of the growing number of such lawsuits is the compensation that employers arrange for payment to the vendors of services to the ERISA plans the employers sponsor.

A crisis among retirement plan sponsoring enterprises is unfolding. The challenge facing their leaders is to ensure that operations managers are equipped with the training, guidelines, controls, and tools that elevate fiduciary risk management to its proper priority.

Underestimating the economic and reputational risks related to deficiencies in the prudent management of ERISA plans threatens an entire enterprise.

Overview of the Vendor Market

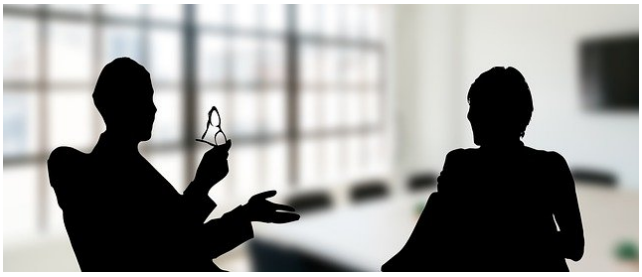
In recent years, there have been several changes in the way services are provided to employee benefit plans and in the way service providers are compensated. Many of these changes may have improved efficiency and reduced the costs of administrative services and benefits for plans and their participants.

The complexity resulting from these changes, however, also has made it more difficult for plan sponsors to understand for what service providers are paid. Consequently, the U.S. Department of Labor commissioned a change to ERISA that requires greater disclosure from vendors about their fees. That change is defined in ERISA § 408(b)(2) offen referred to as the "Reasonable Fee Rule" or simply the "Fee Rule."

An Employer's Duty Under the Fee Rule

Enterprises that sponsor ERISA qualified defined contribution plans must evaluate the expenses paid for their plans' administration and investment related services. It is a fiduciary breach to allow such a plan to pay more than reasonable expenses. Once the responsible plan fiduciaries receive their vendors' fee disclosures, which are mandated by the Fee Rule, they have a duty to evaluate the disclosures, assess their adequacy, and determine the fairness of the vendors' arrangements and fees.

Who are the vendors?



The Fiduciary Supply Chain

In effect, the Fee Rule is a supply chain management statute. The supply chain for ERISA retirement plans includes vendor types that traditionally fall into one of two major categories: fiduciary and ministerial.

The summaries shown beginning on the next page of this briefing provide a snapshot of the service categories that comprise the vendor market for ERISA plan services.

The section reference number in ERISA appears along with each vendor type in order to designate its fiduciary status.

ERISA Plan Market Vendor Categories

A network of vendors exists that provides services to ERISA plans. Its members represent a variety of organizations that include insurance companies, banks, private businesses, registered investment firms, and risk management specialists. The category summaries listed below define the types of services offered by the vendors correlated to relevant ERISA code sections.

Category: The Named Fiduciary - ERISA Designation: 402(a)
The Named Fiduciary is specified in the Plan Document, or who, by virtue of a rule specified in the Plan Document, is the Named Fiduciary. This role may be delegated to an *Independent Plan Administrator*.

Category: Plan Administrator Fiduciary - ERISA Designation: 3(16)
The Plan Administrator is the person or committee designated in the Plan Document to oversee the operation of an ERISA plan. Generally, a Plan Administrator is responsible for interpreting the plan's governance documents, administering the plan in accordance with governance provisions, overseeing the prudent handling of plan assets, managing operations including the plan's payroll interface, appointing other fiduciaries, and monitoring vendors. This role may be delegated to an *Independent Plan Administrator*.

Category: Administrative Fiduciary - ERISA Designation: 3(21)
An Administrative Fiduciary is a hired qualified expert who is responsible for contractually specified activities that directly support the Plan Administrator. Many plan employers engage an *Administrative Fiduciary* that is certified to provide enhanced risk management advice in addition to its support functions for the Plan Administrator.

Category: Investment Fiduciary - ERISA Designations: 3(21) and 3(38)
An Investment Fiduciary is a third-party consultant who either provides advice only [the "3(21) Advisor"] to the Plan Administrator regarding the plan's investment strategy and fund options or to whom the Plan Administrator delegates the duty to make all investment-related decisions on a discretionary arrangement [the "3(38) Advisor"].

Category: Recordkeeper (ministerial) - ERISA Designation: Not a fiduciary
A recordkeeper keeps track of the money that flows through a retirement plan. Recordkeepers are responsible for maintaining the accounting of plan contributions and the earnings that such contributions achieve.

Category: Third Party Administrator (ministerial) - ERISA Designation: Not a fiduciary
Many TPA services are bundled in the programs offered by recordkeepers, while other TPAs are standalone independent businesses. The primary purpose of TPAs is to ensure that retirement plans retain their tax status.

Category: Custodian (ministerial) - ERISA Designation: Not a fiduciary
The primary role of a retirement plan's custodian is to safeguard the assets of a retirement plan and the accounts of the plan's participants. Custodians also allocate earnings and losses to participants appropriately and invest contributions as directed by the Plan Administrator.

The Impact of Mergers

Shrinking Choices

Consolidation among vendors of services to ERISA plans continues unabated. The reorganization of the vendor market for recordkeeping and investment advisory services produces less competition and threatens the quality of the survivors' services if they fail to effectively manage the combination of the involved entities.

While many employers were forced into plan conversions in recent years due to the absorption of their recordkeepers and TPAs by competitors, more mergers and acquisitions among the 35-plus national recordkeepers, and scores of other regional providers, is expected.

The registered investment advisory industry is changing in many ways, too. Operational efficiency is on the rise, not just through technology, but also through mergers and acquisitions. A danger exists in this sector because fiduciary identity lines are obscured when non-fiduciary broker-dealers and banks acquire registered investment advisory ("RIA") firms or launch RIA subsidiaries of their own.

Risk Management Intensifies

An example of the reduction in vendor options is evidenced by our ability to find, on average, only five candidates for the typical vendor searches we conduct on behalf of clients. Not that long ago, the same searches would include as many as eight candidates.

Consolidation of ERISA plan vendors should concern employers. In the long run, mergers may not be good for them or their plans' participants.

An examination of the acquisitions that occurred in the recent decade reveals they were motivated primarily by the acquirers' intent to increase their market share. Consequently, those who benefited most are likely the vendors, not retirement plan sponsors and their workers.

In light of the shrinking number of available vendors, vigilance is demanded of risk and human resources managers regarding the quality of services their vendors provide, and what their employees and beneficiaries are paying for the services.

Anatomy of Excessive Fees

The Fee Rule requires an employer to evaluate their vendors' compensation disclosures, conclude if the disclosures are adequate for the employer's analysis, and document the manner they used to determine the reasonableness of the vendors' arrangements and fees.

An unreasonable fee is an excessive fee.

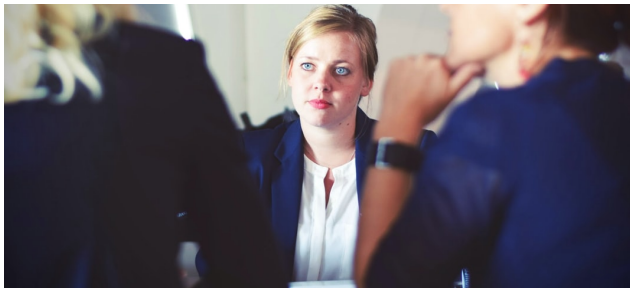
The subject of inappropriate compensation for retirement plan vendors is a dominating theme for many employers. Fees for administration and investment services have declined for three primary reasons: the gradual impact of the Fee Rule, the more frequent use of index funds, and changes in pricing for investment advisory services.

Notwithstanding the downward pressure caused by those factors, many plan fiduciaries continue to pay excessive fees from their plans' assets in violation of ERISA.

Vendors such as stockbrokers, recordkeepers, and TPAs are not fiduciaries to their clients' plans and thus may conceal sources of compensation and engage in conflicts, thereby inflating fees.

In addition, asset-based fee arrangements with recordkeepers and investment advisors result in automatic and unmonitored fee increases as plan assets increase due to contributions and market valuation.

Where to get answers?



In light of the complexity of managing the fiduciary supply chain, savvy employers increasingly retain fiduciary advisors that specialize in ERISA risk management services.

A fiduciary advisor, who is usually engaged as an Administrative Fiduciary under ERISA section 3(21), annually audits service provider fees, investment fund expenses, and fund performance, as well as manages plan governance.

The professional management of plan governance and compliance cuts enterprise and fiduciary risk and improves plan performance.

An Administrative Fiduciary is subject to the high legal standard of prudence and loyalty. A key benefit enjoyed by clients of such a fiduciary is the advisor's experience as a professional purchaser of retirement plan services on behalf of its clients.

A Stunning Growth in Lawsuits

Moving Down Market

The federal courts have seen a flood of class-action lawsuits against employers and their senior managers for alleged violations of ERISA in connection with the defined contribution plans the employers sponsor. Most of the lawsuits make eerily similar claims. As of the date of this briefing nearly two hundred such cases are active and are growing rapidly in number.

For example, twenty ERISA fiduciary violation complaints were filed in 2019 with over ninety filed in 2020. A chilling development is the number of smaller plans that are embroiled in legal action. That marks a change in the plaintiff bar's early strategy of only pursuing employers in the large plan end of the retirement plan community. Litigation involving excessive fee allegations is moving down market.

Predictably, lawsuits charge that recordkeeping and investment fees are too high. Fiduciary liability insurers report they have paid an estimated $1 billion in settlements and well over $250 million in attorney fees in cases that employers were called on to defend such charges.

A vital risk management factor worth paying attention to is the changing availability of fiduciary liability insurance.

Thus far, settlements in excessive fee lawsuits were paid by insurance companies. Insurers say that ERISA-based lawsuits are unpredictable.

Nearly every employer that has a disgruntled employee on its rolls is a potential defendant. For that reason alone, fiduciary insurers are raising premiums, limiting their exposure by contract, and lowering their insurance limits.

Litigation Activity Summary

The list of excessive fee lawsuits shown below is by no means inclusive of the litigation activity spawned by employees that are concerned about the compensation paid to their defined contribution plans' vendors. The entries in the list demonstrate the significant economic risks that confront plan fiduciaries.

A sampling of excessive fee lawsuits that were settled prior to the date of this briefing include those shown on the list below.

Employer	Status	Amount
Brown University	Settled	$3.5 million
M.I.T.	Settled	$8.1 million
Vanderbilt University	Settled	$14.5 million
Johns Hopkins University	Settled	$14.5 million
University of Chicago	Settled	$6.5 million
Duke University	Settled	$10.65 million
Columbia University	Settled	TBA
University of Pennsylvania	Settled	$13 million
Cornell University	Settled	$225,000
Emory University	Settled	$17 million
Vanderbilt University	Settled	$14.5 million
Cerner Foundation	Settled	$4.05 million
Supplemental Income Trust	Settled	$8.75 million
Anthem	Settled	$24 million
ABB, Inc.	Settled	$55 million
Franklin Templeton	Settled	$14 million
International Paper	Settled	$35 million
Teva Pharma USA	Settled	$2.5 million
WakeMed	Settled	$975,000

The list below identifies excessive fee lawsuits that were working their way through the legal system or where the employer prevailed as of the date of this briefing.

Employer	Status	Amount
CDI Corp.	In progress	
University of Tampa	In progress	
NYU	In progress	
University of Southern Calif.	In progress	
Yale University	In progress	
Washington University	In progress	
Quest Diagnostics	In progress	
B. Braun Medical	In progress	
Costco	In progress	
Wesco Distribution	In progress	
Eversource	In progress	
Paychex, Inc.	In progress	
Astellas	In progress	
Land ‘O Lakes	In progress	
Estee Lauder Inc	In progress	
Oshkosh Corp.	In progress	
Automatic Data Processing, Inc.	In progress	
MedStar Health Inc.	In progress	
Astellas US LLC	In progress	
Universal Health Services Inc.	In progress	
Schneider Electric Holdings Inc.	In progress	
CommonSpirit Health	In progress	
Northwestern University	Won	$0

De-Risking a Retirement Plan

The risks from lawsuits associated with ERISA qualified retirement plans are illustrated well by the examples presented in this briefing. Risk management is a key discipline for avoiding excessive fees in ERISA plans.

Employers should engage a qualified consultant to assess the compensation paid to all of their plans' vendors annually.

The U.S. Department of Labor strongly urges employers to conduct a periodic review of their retirement plans' fees and to document the steps used to prove the fees are reasonable. While many enterprises do so, the steps they use often produce the wrong conclusions. *The reasons?*

The market for retirement plan services is characterized by acute information asymmetry. The information costs of plan service providers are far lower than their clients'.

Vendors are specialists in the design of their products, services, and compensation arrangements, and are continually engaged in marketing to plan sponsors. Plan sponsors often lack this degree of specialization. Even very large, relatively sophisticated plan sponsors shop for services only periodically, generally once every three to five years. Smaller, less sophisticated plan sponsors face still higher information costs. As a result, vendors are able to maintain an information advantage over their plan sponsor clients.

Vendors have a strong incentive to use their information advantage to distort market outcomes in their favor.

Current ERISA rules hold plan sponsors rather than vendors accountable for evaluating the cost and quality of plan services. And vendors can reap excess profit by concealing indirect compensation (and attendant conflicts of interest) from clients, thereby making their prices appear lower and their product quality higher.

Evaluating the fairness of retirement plan fees is not a good do-it-yourself project for employers.

Only an expert can explain the hidden fees and other pitfalls. Risk management is more than just purchasing fiduciary insurance. Retirement plan committees must hire an expert, who is vendor-neutral, to de-risk their legal and regulatory exposure.

Roland|Criss has extensive experience in conducting ERISA-based vendor compensation assessments. Its staff is credentialed by recognized investment fiduciary and enterprise risk management standards organizations.

The fees associated Roland|Criss' work are qualified ERISA plan expenses and may be paid either by a retirement plan or the plan's sponsor.

Conclusion

Analyzing a vendor's fees for reasonableness can drain your time, money, and resources, and leave you exposed to a serious legal liability if not done properly. Vendors' fee structures are confusing. A fee opinion from Roland|Criss eliminates the confusion and reduces your enterprise's risk.

Roland|Criss' fee assessments allow for the objective examination of key vendor management practices, vendor agreements, and vendor performance. Our annual opinions of the fairness of your service providers' compensation also take into account the full range of cybersecurity issues promulgated by the U.S. Department of Labor.

Without interruption since 2000, Roland|Criss Fiduciary Services has solved problems for organizations that are charged with the legal duty of managing other people's money. We have provided fiduciary assessment and governance solutions to those serving in the Plan Administrator role during that entire period. While many vendors are just now releasing so-called 3(16) solutions into the market, 3(16) is not new to us. This is our core business, *our only business*. We serve plans of all sizes as a 3(16) Independent Plan Administrator or as a 3(21) Administrative Fiduciary. From startups to complex, layered plan arrangements with billions of dollars in assets, we reduce enterprise risk.

Contact us at **(800) 440-3457** or by e-mail at **excellentfiduciary@rolandcriss.com**.