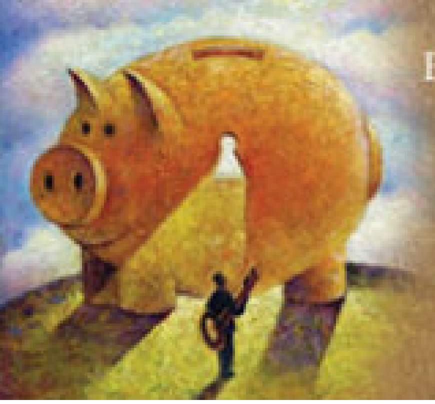

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BENEFITS COMMENTARY

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The Importance of Understanding and Monitoring Retirement Plan Fees and Expenses

Profit sharing plans, 401(k) plans, and other types of defined contribution plans have become the predominant type of retirement plan in U.S. businesses. As we all know, a participant's benefit in a defined contribution plan is not a guaranteed amount but rather simply his or her vested account balance, that is, the vested portion of the contributions made on the participant's behalf and the attributable earnings. This means that the fees and expenses in a profit sharing or 401(k) plan are of critical importance as they have a direct impact on participants' ultimate retirement benefit.

In this *Commentary,* we will discuss the fiduciary duties under the Employee Retirement Income Security Act of 1974 with respect to fees and expenses, describe the more common compensation arrangements in the retirement plan industry today, and provide suggestions for defined contribution plan fiduciaries to monitor and evaluate their plans for compliance with the applicable legal standards.[1]

A number of recent developments underscore the importance and urgency of defined contribution plan fiduciaries being knowledgeable of common fee and expense arrangements and monitoring their plans for compliance. On the regulatory front, the Department of Labor in July 2010 published interim final regulations mandating fee and expense disclosures by service providers to retirement plan fiduciaries, beginning April 1, 2012. That was followed in October 2010 by regulations mandating detailed fee and expense disclosures by plan fiduciaries to participants in defined contribution plans permitting participant investment direction, generally effective for plan years beginning on or after November 1, 2011 (subject to transition relief for the initial disclosures). Of equal or perhaps even greater importance, a number of lawsuits have been brought against fiduciaries and service providers for large 401(k) plans over the past several years alleging a lack of

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[1]The focus of this *Commentary* will be on defined contribution plans subject to Title I of the Employee Retirement Income Security Act of 1974, as amended (or "ERISA"), the federal law governing retirement plans. This includes most retirement plans other than governmental plans, plans of churches or church conventions that have not elected to be subject to Title I of ERISA, and plans covering only a sole business owner, a sole business owner and his or her spouse, a self-employed individual, or self-employed individuals and their spouses. The law governing the fiduciary obligations under governmental and nonelecting church plans is sparse at best; more than likely, however, governmental and nonelecting church plans that satisfy the rules governing Title I plans will likely satisfy the applicable fiduciary standards, save for the rare statute providing a contrary rule.

Also excluded from this *Commentary* is a discussion of non-investment related administrative expenses. While those expenses must also be reasonable, by far the largest components of plan expenses are investment-related expenses; in fact, investment-related expenses often account for 90%-95% of all plan expenses.

proper oversight and other breaches concerning the fees and expenses charged. In one recent decision, the plan fiduciaries in a $3.8 billion plan with professional advisors were held to have breached their duties in the selection of funds made available for participant investment direction due to the fees and expenses attendant to the fund options. In another decision, a federal appeals court permitted discovery to proceed in a case involving similar issues in the $10 billion Wal-Mart Profit Sharing and 401k Plan. These and other "excessive fee" cases are currently winding through the courts, and plaintiff-friendly decisions in these cases have the potential to spawn "copy cat" suits against fiduciaries of smaller plans with less access to outside professional advisors. For plan fiduciaries who have not focused on fees and expenses, the cumulative effect of these developments should be a wake-up call of the importance of doing so.

Fiduciary Duties Generally

Every retirement plan must have one or more named fiduciaries who have the authority to control and manage the operation and administration of the plan. A person is a fiduciary with respect to a retirement plan to the extent he or she exercises discretionary authority or control over the management of the plan, renders investment advice for a fee, or has any discretionary authority or responsibility in the administration of the plan. The test of fiduciary status is not simply one of title or position; in addition to the persons designated as the trustee and the plan administrator, a person will be considered a fiduciary if he or she exercises any of the fiduciary functions or exercises de facto control over a fiduciary function. Thus, when the employer/plan sponsor is the "named fiduciary," officers, directors, and managers of the entity could be also considered fiduciaries subject to ERISA's exacting fiduciary standards.

Among the obligations of a fiduciary is the duty to discharge his or her duties solely in the interests of participants and beneficiaries for the exclusive purposes of providing benefits and defraying the reasonable expenses of administration. A fiduciary must also discharge his or her duties with the care, skill, prudence, and diligence under the circumstances that a prudent person would use in the conduct of an enterprise of like character and with like aims. This is often referred to as the "prudent expert" requirement.

A fiduciary who lacks the necessary training or skills must retain an expert to assist him or her; reliance on the expert, however, will generally not be justified unless the fiduciary first determines that the expert is independent (i.e., unbiased and generally without conflicts of interest), qualified, has been provided complete and accurate information, has undertaken a sufficient analysis to make an informed decision, and his or her conclusions appear reasonable.

A fiduciary is personally liable to the plan for losses arising from a breach of fiduciary duty. Stated differently, a fiduciary is personally liable to make "whole" the plan participants for the consequences of his or her breach even if he or she did not personally benefit. In addition, a breach of fiduciary duty could subject the fiduciary to penalties imposed by the Secretary of Labor.

A fiduciary is not a guarantor of benefits or even favorable investment results. The reasonableness of a fiduciary's actions will be judged by whether the fiduciary engaged in a careful, deliberate, thought-out course of action based on the information then at hand (or available in the exercise of reasonable diligence) and not whether there was a successful outcome. Accordingly, to prevail on a claim that a plan paid unreasonable fees and expenses, a participant must prove something more than the fact that the fiduciaries could have utilized less expensive investment options; rather, the claimant must establish that the fiduciaries failed to engage in a prudent process and that the fees and expenses paid were not reasonable.[2]

Legal Requirements for Service Provider Agreements

In addition to properly discharging his or her fiduciary duties, a plan fiduciary must also assure that the administration of the plan does not result in a prohibited transaction, as doing so could subject one or more of the parties involved to an excise tax until the transaction is "corrected" and could subject the fiduciary to a civil penalty imposed by the Department of Labor. Unless an exemption applies, the prohibited transaction rules generally preclude sales or exchanges, extensions of credit and most other transactions between the plan and a party with a close relationship with the plan, such as the plan sponsor, officers, directors, and owners of the plan sponsor, and service providers to the plan. This is the case even if the transaction is favorable to the plan or its participants.

An important exemption to the prohibited transaction rules applies to agreements with service providers for reasonable contracts or arrangements for services necessary for the establishment or operation of the plan and for which no more than reasonable compensation is paid. Until recently there had been little in the way of guidance on what constituted a "reasonable" arrangement other than the requirement that the agreement be terminable on reasonably short notice and without penalty. That changed in July 2010 when the Department of Labor issued regulations mandating extensive written fee and expense disclosures to plan fiduciaries in order for new service provider agreements and renewals or extensions of existing agreements to be considered to be reasonable arrangements for purposes of this exemption.[3]

The Impact of Excessive Fees and Expenses

One need look no further than the Department of Labor's website for an illustration of the impact of excessive fees and expenses on a participant's retirement benefit. In its example,[4] the Department of Labor illustrates the impact of an excessive expense of 100 basis points (or one

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[2]The protection afforded to fiduciaries by ERISA Section 404(c) may not be of benefit here. Despite some court decisions to the contrary, the Department of Labor's view is that ERISA Section 404(c) only protects a plan fiduciary from liability for losses that are a direct result of a participant's exercise of investment control over the assets of his or her account and provides no protection from liability for the selection of the investment options made available for participant direction. Under that view, ERISA Section 404(c) provides no protection to rebut an allegation that unreasonably expensive funds were made available for participant direction.

[3]DOL Reg. § 2550.408b-2; See footnote 11, *infra*.

[4]See "A Look at 401(k) Plan Fees" at http://www.dol.gov/ebsa/publications/401k_employee.html.

percentage point)[5] under a defined contribution plan earning 7% a year. Assuming the amount will be held 35 years until retirement, the 100 basis point excessive expense would result in a 28% reduction in the participant's account balance at retirement.

Most have probably seen the charts used in 401(k) enrollment materials illustrating how even modest periodic contributions can, over time, accumulate to sizable sums, thus enabling even modest savers to retire as "pension millionaires." If one simply considers those charts in reverse, one can see the harmful effect of excessive fees and expenses. Just as the magic of tax-free, compound earnings can cause small amounts to grow into large balances at retirement, so too the same tax-free compounding can cause what at first blush appear to be minor expense amounts to be magnified into substantial reductions in the ultimate value of the investment years hence.[6]

Should the Focus Instead be on Net Returns?

One might ask whether the emphasis is misplaced to focus on fees and expenses rather than on investment returns, net of expenses. The short answer is that a focus on investment returns will likely not be a problem, at least until a dispute arises. Fundamentally, though, a focus on performance is inconsistent with the fiduciary duties under ERISA. As noted earlier, the test of a fiduciary is not the results obtained but rather whether the fiduciary engaged in a prudent investigation and made an appropriate decision based on the facts available at that time. The Securities and Exchange Commission admonishes us that "past performance is no guarantee of future success," and the Reporter's General Note on the Restatement of the Law of Trusts-3d (Prudent Investor Rule) observes that "evidence shows that there is little correlation between fund managers' earlier successes and their ability to produce above market returns in subsequent periods." In light of this, a fiduciary who focuses primarily on returns, even net returns, may find it difficult to defend a claim that excessive fees and expenses were incurred. Instead, a more prudent approach for a fiduciary is to manage those things that it can control – risk and expenses.

Common Fee and Expense Arrangements – Direct Compensation

The following describes the more common direct compensation arrangements:

- *Mutual Fund Investment Management Fees.* For most retirement plans, the mutual fund investment management fees paid is the largest component of the overall investment fees and expenses incurred. Its purpose is to compensate the investment manager who researches and recommends the allocation of investments consistent with the fund's objective and undertakes the continued management and monitoring of those investments.

[5]Basis points are a shorthand method of referring to percentages without the use of a decimal notation. One basis point means 1/100 of 1%, so 100 basis points equals one percent.

[6]The FINRA website offers an interactive tool that provides information about fees and expenses and allows users to assess the impact of fees and expenses on investment return in more than 18,000 mutual funds, exchange traded funds, and other investments. FINRA is the acronym for the Financial Industry Regulatory Authority, the largest independent regulator of securities firms doing business in the United States. The calculator can be found at http://apps.finra.org/fundanalyzer/1/fa.aspx.

Investment management fees are generally stated as a percentage of the amount of assets in the fund (such as 65 basis points) and are deducted directly from the fund, which thereby reduces the investment return. Because these fees are netted in calculating the investment returns and are not separately stated, their effect may not be readily apparent. The level of management fees can vary widely depending upon the investment manager and the investment objective of the fund. For example, funds investing in stocks of companies with small market capitalization will have greater expenses than funds invested in companies with large market capitalization due to the extent of the additional research needed and the fact that public information is not as readily available for smaller capitalized companies as it is for companies with larger capitalization. Similarly, "active" investment managers will incur larger expenses than managers pursuing a passive investment management strategy.[7]

- *Investment Advisory Fees.* Separate and apart from, but perhaps in addition to, the internal management expenses of a mutual fund, a plan may be paying a management fee to an investment manager or investment advisor. Those fees may be used to compensate the manager or advisor to exercise discretionary investment control over the plan assets (or a portion of the plan assets) or to provide recommendations of the mutual funds and other investment options to be offered for participant investment direction. Services often provided as part of these fees include handling or assisting the plan administrator with participant enrollments and educational efforts.

- *Fund Share Classes/Load Fees.* Mutual fund investments are often sold in multiple share classes with varying annual investment management fees charged for the same mutual fund. The share class utilized is a function of the amount of plan assets to be invested and the revenue sharing *(see below)* to be paid, with a higher annual investment management fee charged the smaller the plan assets to be invested and the larger the revenue sharing to be paid. Mutual funds with multiple share classes are used frequently in plans with a limited amount of assets.[8]

Less prevalent these days are mutual funds that impose front-end or back-end charges. Some mutual funds charge an upfront charge or "load" as deposits are made to the fund. For example, in a fund with a 3% load, a deposit of $100 will result in $97 being deposited in the mutual fund and the $3 will be used to compensate parties involved in selling and servicing the investment *(see "Revenue Sharing" below).* In contrast, some mutual funds impose a back-end load (or as commonly known, a contingent deferred sales charge or

[7]Funds that are "actively managed" (i.e., funds with an investment manager who continually researches, monitors, and actively trades the holdings of the fund to seek a higher return than the market) generally have higher fees. The higher fees are associated with the additional research and oversight required and the sales charges from the higher level of trading activity. Funds that are "passively managed" generally have lower management fees. Passively managed funds most frequently seek to obtain the investment results of an established market index, such as the Standard and Poor's 500, by duplicating the holdings included in the index. Thus, passively managed funds require little research and less trading activity than actively managed funds and consequently have lower expenses. While actively managed funds seek to provide higher returns than the market, neither active management nor higher fees necessarily guarantee higher investment returns.

[8]See also "The Impact of Plan Size on Fees and Expenses," *infra*.

"CDSC") if amounts are withdrawn before a specified period of time. The purpose of the back-end charges is to assure that the mutual fund recaptures any sales commissions and start-up costs it incurred initially. Typically, the amount of the charge declines over time.

• *Annuity Contract Wrap Fees.* Frequently, smaller plans will utilize an annuity contract issued by an insurance company as the funding medium for the plan. These are typically structured whereby the plan invests the contributions and accumulated earnings in the annuity contract, which in turn invests those amounts among a number of mutual funds. Rather than simply passing through the fees and expenses of the mutual funds, the insurance company will typically impose a single "wrap" fee for all of the component services being provided, including investment management fees, surrender charges if withdrawals are made within a specific period of time, mortality and expense charges, administrative and recordkeeping fees, and fees for other features, such as an increased death benefit or a guaranteed retirement benefit. Annuity contract wrap fees will exceed the cost of direct investment in the mutual funds due primarily to the fee charged by the insurance company for the insurance coverage in those products. Annuity contracts typically impose surrender charges upon termination of the contract.

• *Other Costs.* There are also other direct costs that may be incurred. Commissions may be charged on sales and purchases of investments; fixed commission rates no longer apply, however, these costs are fairly standard except for larger plans that have the leverage to negotiate lower commission rates.[9] Some broker-dealers offer "wrap accounts" under which a fixed fee is paid in lieu of commissions on individual trades.

Alliance or network fees may also be imposed. For example, a particular mutual fund may provide recordkeeping services for certain other mutual fund families on its own trading and recordkeeping platform. Thus, mutual family fund A may recordkeep not only its own funds but also the mutual funds of families B, C, and D on Family A's platform. In those instances, the costs paid Family A to recordkeep other mutual fund family funds are frequently passed through directly to the plan or plan participants investing in those funds using that platform.

Trading platforms sometimes impose fees for utilization of the platform. These fees are typically denominated as an "asset management fee," the rate of which usually decreases as the level of the plan assets increases. These fees are in addition to the internal mutual fund management expenses and, if applicable, the outside investment advisory fees.

Fees may also be charged for additional services, such as fees to utilize participant investment advice services or for special plan features, such as a self-directed brokerage option.

[9]Commissions are not the only costs involved in buying and selling stocks. Broker-dealers also profit from the bid-ask spread, which is the difference between the price at which stocks may be sold and at which they may be purchased. Generally speaking, the more liquid the stock, the smaller the spread.

Common Fee and Expense Arrangements – Revenue Sharing and Indirect Compensation

Revenue sharing is a generic term used to describe the practice of transferring asset-based compensation from mutual funds and other investment providers to service providers who support retirement plans. Many investment and recordkeeping service providers engage in this activity to some degree as it is often difficult to compete in the marketplace without offsetting a portion of service cost through the use of asset-based revenues (especially in smaller plans). The more common types of revenue sharing and indirect compensation are described below:

- *12b-1 Fees.* 12b-1 fees are fees paid by a mutual fund as a sales or marketing commission to a broker-dealer or other investment advisor for selling the mutual fund or paid to a person or entity for servicing the account after the sale. Since first allowed in 1980, mutual funds are permitted to increase their internal fund expense ratio by up to 1% for all 12b-1 fees. These fees are assessed in the same manner as other mutual fund expenses (i.e., they are an annual charge). About one-half of all mutual funds pay 12b-1 fees.[10] 12b-1 fees are typically paid to broker-dealers servicing retirement plans and to third party administrators handling the annual testing and other recordkeeping obligations.

- *Collective Investment Trust Revenue Sharing.* Collective investment fund revenue sharing is the counterpart to 12b-1 fees with respect to collective investment funds of banks and other financial institutions.

- *Sub-Transfer Agency Fees.* At their simplest, sub-transfer agency fees represent contractual payments made by mutual funds and other investment managers to service providers in exchange for specified services. Most frequently, a mutual fund will pay a per capita fee to a service provider to individually recordkeep for the participants in the fund, thereby allowing the mutual fund to use an omnibus account rather than having to maintain voluminous individual accounts. The service provider may then undertake to handle other aspects of the recordkeeping, including maintaining individual participant accounts, issuing account statements, confirmations, and tax statements, and maintaining all customer service functions. In addition to compensating the service provider for the additional recordkeeping duties, the payments also serve as an incentive for the distribution of the investment product through the service provider.

- *Finder's Fees/Retention Bonuses.* Finder's fees are in the nature of a bounty on new money; a mutual fund family will sometimes pay a one-time fee to a broker-dealer or other investment advisor for the investment of new money. Similarly, some mutual fund families may pay amounts to broker-dealers and other investment advisors for the attainment of specified sales goals or certain levels of business retained.

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[10] 12b-1 fees were originally permitted on the theory that they would help investors in the fund; as assets in the fund grew, the argument went, the fund's expense ratio would decrease because the fund's total expenses would be spread across a larger pool of investors. Persuaded in part by the fact that the amount of Section 12b-1 fees paid has gone from just a few million dollars in 1980 to $9.5 *billion* in 2009, the Securities and Exchange Commission recently proposed significant limits on amounts that can be paid from mutual funds for advertising, sales compensation and services.

The Impact of Plan Size on Fees and Expenses

The size of the plan is an important factor in the amount of the fees and expenses charged. This is largely a result of the fact that there are certain fixed costs of providing services to a plan that are not dependent upon the number of participants. Thus, with fewer participants, the amount of fees per capita may be significantly larger in smaller plans.

The harsh reality is that smaller plans have fewer choices of investment and service providers than larger plans, and as a result are more likely to end up with a bundled product – where a single provider or affiliated providers offer the investment funds and handle the recordkeeping, participant communications, and reporting and disclosure matters. In those situations, there is generally a single fee charged, which has the effect of camouflaging the costs of particular, discrete services. Moreover, smaller plans are often relegated to utilizing insurance company annuity products or mutual fund share classes with high annual investment fees, both of which tend to be the more expensive of the available offerings.

Unlike smaller plans that are typically forced into "retail" mutual funds, larger plans have more options. For example, larger plans generally may invest in institutional class mutual funds, which have lower expense ratios than do "retail" mutual funds with similar holdings and risk characteristics. Very large plans can achieve even greater savings in investment management expenses by utilizing separately managed accounts, which, as the name connotes, refers to a separate fund managed solely for that plan in accordance with the investment objectives and target portfolios directed by the plan fiduciaries.

Difficulty in Determining the Actual Fees and Expenses Being Paid

Numerous factors have made it difficult to understand the total fees and expenses being paid by a retirement plan and to ascertain whether they are reasonable. Media reports suggest that foremost among those factors is a lack of understanding by many fiduciaries as to the types and expenses common in the industry.

This lack of understanding can be traced in part to the lack of transparency in how fees and expenses have been historically reported. While many (but not all) fees and expenses are disclosed in the prospectus, many fees and expenses are difficult to discern because they are deducted from the investment return, rather than being shown as a separate expense line item. Even more opaque are transaction costs of a fund (e.g., trading commissions), especially in funds that have a high turnover ratio, and market impact costs, for example, when a fund decides to invest in, or divest itself of, a large block of stock.

Also contributing to this knowledge deficit is the fact that different providers price things differently, making an apples-to-apples comparison difficult at best. Moreover, the dizzying array of available platforms makes comparisons burdensome. For example, plan costs are affected by the administrative delivery system (i.e., bundled or unbundled), the investment architecture (i.e., closed or open), and the distribution network (e.g., broker-dealer, an insurance company product, a registered investment advisor, a third party administrator alliance with a mutual fund family, etc.).

The more layers involved in the administration, money management, and distribution systems, the more difficult it has been to discover the embedded costs.

As incredible as it sounds, until recently plan service providers were under no legal obligation to provide fee and expense information to plan fiduciaries absent a contractual obligation to do so. Fortunately that has changed as interim final regulations issued by the Department of Labor in July 2010 mandate that virtually all plan service providers provide detailed written fee and expense information (including revenue sharing information) to plan fiduciaries beginning April 1, 2012.[11]

Suggested Actions for Plan Fiduciaries

The obvious first step for fiduciaries is to become educated as to the types of fee and expense arrangements common in the industry. Media reports suggest that many fiduciaries are unfamiliar both as to the different categories of fees and expenses and which of those are being paid from their plans. Case law confirms that a clean heart and an empty mind are no defense to a claim of breach of fiduciary duty.

The next step is to obtain from all parties in the distribution and administration networks (including consultants, broker-dealers, and all other service providers) disclosure in writing of all fees and expenses being paid from the plan, either directly or indirectly through revenue sharing. Revenue sharing compensation is often paid to affiliated parties, so it is imperative to obtain an accounting of all amounts paid to all parties. After April 1, 2012, those disclosures will be mandatory. Before that date, plan fiduciaries should closely scrutinize (and consider replacing) service providers who fail or refuse to provide that information.

Armed with the fee information, the fiduciary should verify the information provided both for accuracy and for reasonableness for the services received. The lack of readily available comparable data makes this a somewhat daunting task. Some comparative information is available through commercial services, although care must be exercised to assure a true comparison in which all fees are reported similarly. At one time, the Department of Labor had some expense ratio data available on its website, although it is now dated. The information reported on the Form 5500 annual report (and available for public inspection) should not be relied upon for this purpose; that form only reflects expenses paid by the plan (not the plan sponsor) and does not reflect expenses netted in calculating the investment returns. Many experts consider obtaining proposals from multiple providers, preferably following a request for proposal that requires standardized responses,

[11] DOL Reg. § 2550.408b-2. Every covered plan service provider who enters into a contract with a covered retirement plan and who reasonably expects to receive $1,000 or more in direct or indirect compensation in connection with providing certain enumerated services must make these disclosures, regardless of the size of the recipient plan. Special rules apply to aggregate service providers and their affiliates and subcontractors for this purpose, and expenses for recordkeeping services must generally be separately stated. A plan fiduciary to whom a covered service provider refuses to provide the required disclosures will be protected from liability if the plan fiduciary requests the information in writing and notifies the Department of Labor within certain time frames; the fiduciary may also be obligated to terminate the arrangement. These regulations were originally effective July, 16, 2011, but the effective date has now been extended to April 1, 2012.

as the most accurate way to obtain a true comparison. More recently, fee benchmarking services have become more prevalent and more readily accessible to smaller plans to assess the reasonableness of fees and expenses.

Fiduciaries should consider not only the reasonableness of particular items but also the reasonableness of fees and expenses in the aggregate. In reviewing the fees and expenses for reasonableness, the fiduciaries must bear in mind that the fees and expenses paid often do not reflect the cost of the provider to render those services (or even the value of those services, for that matter). In most cases, the fees are based on asset values, not the services being provided; there are certain costs in providing recordkeeping and other administrative services, and everything above that is simply profit to the provider.

Fiduciaries in plans with investments paying revenue sharing must be mindful of the potential for conflicts of interest. Since different investment options pay different levels of revenue sharing, an investment advisor's judgment could be compromised by the amount of compensation the advisor is to receive, thereby resulting in higher fees or less desirable investment options.

If the review reflects or suggests excessive fees, the fiduciaries should initiate a frank discussion with the provider(s) and attempt to negotiate lower fees and expenses. This may be in the form of outright reductions, rebates, or the application of revenue sharing to offset administrative expenses. Most providers will likely be willing to deal – as a smaller percent of something is better than 100% of nothing.

It should go without saying that periodic reviews are a must. The frequency of reviews will depend upon the facts and circumstances.[12]

As part of the periodic reviews, fiduciaries should request the plan's investment providers to provide benchmarking data to assist the fiduciary in making comparisons for reasonableness, although fiduciaries should not rely on that information without verification that the appropriate benchmarks are being utilized. For example, fee and expense information for actively managed mutual funds would be inappropriate to determine the reasonableness of fees and expenses with respect to passively managed mutual funds.

Larger plans may find it appropriate to engage an independent professional to assist in determining whether fees and expenses are reasonable in amount. Smaller plans would likewise benefit from such a review, but it may be cost-prohibitive depending upon the size of the plan. Regardless of plan size, reliance upon a consultant is not justified when, among other things, the consultant is not free from conflicts of interest. Because of the potential for conflicts, this means that a consultant assisting the fiduciaries in evaluating fees and expenses must not be receiving any revenue sharing compensation and even when revenue sharing compensation is not being received,

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[12]Although it may seem somewhat counterintuitive, smaller plans may need more frequent reviews than larger plans, primarily to determine if the size of the plan has grown sufficiently that the plan may take advantage of less costly alternatives, such as a less expensive mutual fund share class or an unbundled arrangement – where all plan services are not provided by the same party or related parties.

the fiduciaries must also assure that they have the consultant's complete loyalty. For example, a consultant will be eager to maintain favorable relations with money managers if he or she also sells services to those money managers. If that consultant is negotiating fees and expenses on behalf of the fiduciaries, he or she may not be negotiating as forcefully as he or she should. For these reasons, consultants to be engaged must be scrutinized for factors that might impair their independence.

Finally, fiduciaries should assure that procedures are in place to satisfy the recently issued Department of Labor regulations that mandate detailed disclosure of fee and expense information to participants.[13] While a detailed discussion of those rules is beyond the scope of this *Commentary*, it is noteworthy that the Department of Labor regards the obligation to provide participants with sufficient information to make informed investment decisions as part of the plan fiduciary's general obligation to act prudently and solely in the interests of the plan's participants and beneficiaries; these regulations require most defined contribution plans that permit participant investment direction to provide specific fee and expense information to participants at enrollment, quarterly, annually, and at certain other times, generally effective for plan years beginning on or after November 1, 2011 (subject to transition relief for the initial disclosures).[14]

Documenting Due Diligence

As noted previously, a fiduciary is not a guarantor of benefits or even favorable investment results and is to be judged by the extent of the investigation undertaken, not the ultimate outcome. The failure to adequately document the investigative actions and the decisions made could be fatal in establishing this procedural prudence. In any dispute, a lack of adequate substantiation will undoubtedly be viewed with great skepticism; with the benefit of hindsight, a lack of good records will naturally cause the fact finder to focus more on the ultimate outcome, rather than the information available when the action was taken or the decision made. Prudent fiduciaries should, therefore, ensure procedures are in place to contemporaneously document in writing all due diligence undertaken when reviewing fees and expenses.

Concluding Thoughts

Recent studies have shown that many plan participants have unrealistically optimistic expectations as to what will be needed to support them in their retirement years and/or are woefully underfunded to meet their retirement needs. These and other factors lead many commentators to predict that there will be a significantly greater level of employee benefits litigation in the future as baby boomers and others retire and discover that they are inadequately prepared for retirement. Only time will tell whether those predictions will prove correct. Nevertheless, a prudent fiduciary should consider how his or her actions will appear in hindsight; monitoring the fees and expenses of the plan and, ultimately, the amounts participants are paying and contemporaneously documenting

[13] DOL Reg. § 2550.404a-5.

[14] Under the transition relief, the initial disclosures required to be provided before the participant can first direct his or her investments will not have to be furnished before May 31, 2012. The initial quarterly disclosures must be furnished within 45 days of the end of the quarter in which those pre-initial investment direction disclosures are required to be made. DOL Reg. § 2550.404a-5(j)(3).

these actions will be a positive step toward minimizing the potential for fiduciary liability. If the plan and each participant's account in the plan continues to perform well, the lack of monitoring or documenting the due diligence may not be a problem. But if the opposite is true, the fiduciaries may find themselves in a difficult position defending themselves against disgruntled participants or the Department of Labor complaining on their behalf.

Aside from minimizing potential fiduciary liability, plan sponsors and fiduciaries who are genuinely interested in the ability of plan participants to adequately save for retirement need to monitor fees and expenses. As the Department of Labor's example illustrates, plan participants may potentially retire with a considerably smaller retirement fund than they would have had fees and expenses been more closely scrutinized.

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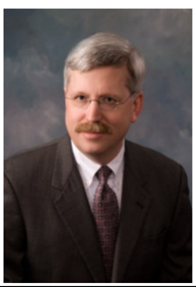

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