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Impact of Fee Litigation on Design of DC Plans

DiMeo Schneider & Associates, LLC aims to help retirement plan sponsors mitigate potential risks

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STEVE DUFAULT is the Defined Contribution Practice Leader and Senior Consultant at DiMeo Schneider & Associates, LLC,[1] a Chicago-based investment consulting firm that advises hundreds of institutions (including corporations, hospitals, schools, charities, and associations) and affluent families. We spoke with him about what plan sponsors can do to manage the risks and opportunities in the DC space.

Given recent 401(k) and 403(b) fee litigation, what should plan sponsors do to mitigate their risk of being sued?

STEVE DUFAULT: While it is difficult to fully insulate against being sued, we believe that plans should take the following basic steps:

- Establish, document, and follow written policies and procedures with respect to various components of plan governance, including (but not limited to) an investment policy statement, an investment committee charter, administrative procedures, and most importantly what is written in the plan document.
- Separate settlor and non-settlor functions/decisions/meetings.
- Retain documentation regarding deliberations and decisions, including justifications for decisions.

In short, be specific and transparent at every turn and show that you have been thoughtful in your decision-making process.

What types of fee benchmarking does your firm use and provide to clients?

DUFAULT: Fees are top of mind for everyone these days. To that end, we have worked with various partners to create a proprietary database containing detailed plan design and fee data for more than 300 401(k) and 403(b) plans. Our database is unique: We are able to delineate administrative costs, investment management fees, and any remaining revenue sharing across more than a dozen vendors and a wide range of plan sizes. We utilize this proprietary database as the foundation for our ongoing fiduciary oversight services known as the “Fiduciary Focus,” which is a comprehensive quarterly review and evaluation incorporating critical standards set forth under ERISA and section 404(c). As part of this program, we benchmark plan design features, investment menu design, and plan fees annually. The result of each quarter's Fiduciary Focus and benchmarking is specific recommendations and action items for each client.

Plan sponsors benefit from these proprietary resources as well as from market surveys, which can provide a level of comfort that plan fees and services can be considered reasonable. A good rule of thumb is to conduct recordkeeping/administration pricing requests for information (RFI) every three to five years and full requests for proposals (RFP) every five to seven years.

How is fee litigation affecting plan investment options?

DUFAULT: The lawsuits have brought added attention to the use of proprietary investment products, mutual fund share classes, and investment structure (mutual funds, collective investment trusts, separate accounts) as well as the prevalence of passive products. The key for fiduciaries is to follow a thorough process and clearly document the three D's (discussions, deliberations, and decisions) when evaluating investment menu design options.

What would DiMeo Schneider's ideal investment lineup for clients look like?

DUFAULT: We recommend a multitiered investment menu based upon each client's unique demographics. The tiers include a default fund to appeal to the uninterested investor, a sleeve of both active and passive investment options across major asset classes, and possibly a self-directed brokerage account for the more sophisticated investor. Specific asset class recommendations are based on a client's interests, plan demographics, and participants' investment sophistication. The tiered approach can also be accomplished with custom "white label" funds that incorporate multiple asset classes in one option.

The "white label" or fund-of-funds approach simplifies the decision making for participants by reducing the number of investment options available for investment but can actually increase the diversification in asset classes offered within a plan. This is accomplished by adding asset classes to the "white label" funds that would not typically be appropriate as standalone options. For example, a diversified "white label" bond fund might include an allocation to domestic high-quality bonds, inflation-protected securities, and high-yield, foreign developed, and emerging markets bonds. These fixed income investments provide significant diversification opportunities within a diversified portfolio; however, as standalone options, some of these asset classes exhibit volatility that may be more than a participant would expect for a fixed income investment. This is the benefit of "white label," simplifying the investment menu but increasing the underlying diversification of each standalone option.

What are your thoughts on outcomes-based solutions that target income?

DUFAULT: There is an education hurdle to outcomes-based solutions, such as income. From a planning standpoint, we believe it is much easier for plan participants to consider a target dollar value rather than a target percentage of final pay. The breakdown of information into usable data points to approximate a monthly target income improves chances of success, as goals may seem more attainable. We have promoted this approach and are happy to see recordkeepers making significant headway in this area.

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2. For the latest on the DOL fiduciary rule, see *http://tinyurl.com/dlapiper-dol*.

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