



# Employee Benefit Plans

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## Plan Expenses: How Much Is “Too Much?”

*Service fees ... investment advisory fees ... front-end loads ... account maintenance fees ... surrender and transfer charges ... investment management fees ... 12b-1 fees.*

Among other duties, The Employee Retirement Income Security Act (ERISA) requires that those responsible for managing retirement plans ensure that the services provided to their plan are necessary and that the cost of those services is reasonable.

### The Challenge of Apples To Oranges

Unfortunately, most companies reviewing proposals for a new or takeover plan do not have a system in place to compare plan expenses. They have no way of knowing if the expenses being paid on their 401(k) plan are ‘reasonable.’ And the investment companies don’t help: Each provider has a different format for presenting the information, making an apples-to-apples comparison difficult.

While fee structures in 401(k) arrangements can be very complex, as a general rule, fees are calculated in four ways:

**Asset-based:** Expenses are based on the amount of assets in the plan and generally are expressed as percentages or basis points.

**Per-person:** Expenses are based upon the number of eligible employees or actual participants in the plan.

**Transaction-based:** Expenses are based on the execution of a particular plan service or transaction.

**Flat rate:** Expenses are reflected in a fixed charge that does not vary, regardless of plan size.

Note that fees may be calculated using one or any combination of these methods. Plan administration-related expenses can also be charged as one-time fees or ongoing expenses. One-time fees are typically related to start-ups, conversions (moving from one provider to another) and terminations of service. Ongoing fees are recurring expenses relating to continuing plan operation.

## Active vs. Passive Management

In addition, funds that are “actively managed” (i.e., funds with an investment advisor who actively researches, monitors and trades the holdings of the fund to seek a higher return than the market as a whole) generally have higher fees than funds that are “passively managed.” Remember that neither active management nor higher fees necessarily guarantee higher returns. Funds that are “passively managed” generally have lower management fees. Passively managed funds 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.

## Weigh Your Options

Understanding and evaluating plan fees and expenses associated with plan investments and services are an important part of a fiduciary’s responsibility. Consider following these general guidelines to establish an objective process to aid in your decision making.

**Decide what you want.** Before negotiating with service providers, think about the specific services you would like (e.g., legal, accounting, trustee/custodian, recordkeeping, investment management, investment education or advice). Include the types and frequency of reports you wish to receive, communications to participants, meetings for participants, and the frequency of participant investment transfers.

**Request estimates.** Once you have a clear idea of your requirements, you are ready to begin receiving estimates from prospective providers. Give each of them identical information about your plan and the features you want. This information should include the number of plan participants and the amount of plan assets as of a specified date. In addition, ask each prospective provider to be specific about which services are covered for the estimated fees and which are not.

**Compare apples to apples.** When making comparisons, use the same format for each prospective provider. The U.S Department of Labor offers a downloadable *401(k) Plan Fee Disclosure Form* on its website ([www.dol.gov/ebsa/pdf/401kfefm.pdf](http://www.dol.gov/ebsa/pdf/401kfefm.pdf)). The form can help you compare investment product fees and plan administration expenses charged by competing service providers, regardless of how a particular service provider structures its fees.

**Ask the right questions.** Make sure prospective providers know you are paying attention to fees and expenses. Ask questions such as, “How are you paid?” “How do these fees compare to industry averages?” “How do they compare to other plans designed like ours?”

## **Weigh Your Options (continued)**

**Consider calling in the pros.** There are a variety of firms that can assist in evaluating your plan fees and expenses. Accounting firms, in particular, are skilled at this type of evaluation.

**Monitor.** Once you have selected a service provider or investments, be prepared to monitor the level and quality of the services and performance of the investments to make sure they continue to be reasonable and that they suit the needs of your employees. For example, request that your provider conduct a performance analysis at least annually of investments utilized by the plan versus benchmarks and/or peer groups.

## **A Word About Quality**

Remember, your fiduciary obligation is to make prudent decisions for participants based on facts—not get the cheapest rates and fees. Ultimately, you get what you pay for.

It is easy to focus on the dollar amount of fees and expenses. But the real question is what are you getting for the money? Will your advisor come onsite regularly to meet with new hires? Will your advisor come in once a year and provide a performance overview to management and employees? Will your advisor make appointments with individual employees to answer questions and address concerns?

The bottom line is that it's okay to pay for service — just make sure you're getting service that adds value to the plan and to your employees.

## **Another Reason To Consider Fees**

In addition to the regulatory requirements, appropriately managing fees and expenses is important for another reason: It impacts investment returns and the eventual retirement balance of participants.

Consider an employee with 35 years until retirement and a current 401(k) account balance of \$25,000. Let's assume investment returns average 7 percent over the next 35 years. If fees and expenses reduce average returns by 0.5 percent, the account balance will grow to \$227,000 at retirement, even if there are no further contributions to the account. On the other hand, if fees and expenses are 1.5 percent, the account balance would grow to only \$163,000. The 1 percent difference in fees and expenses would reduce the account balance at retirement by 28 percent!

If you would like some assistance in assessing the level of fees being paid by or for your plan, please call your partner or manager contact with our Firm and we would be happy to help you.

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## Plan Participation: Is Automatic Enrollment The Answer?

The numbers are hard to ignore: The national average for participation in automatically enrolled 401(k) plans is between 85 and 95 percent—considerably higher than the two-thirds level of participation for non-automatically enrolled plans.

And the Pension Protection Act of 2006 (PPA) has made it even easier for plan sponsors to automatically enroll employees. Now, companies can choose to gently nudge their workers toward saving by automatically signing them up for the firm's retirement plan. Once eligibility requirements are met, contributions are automatically deducted from their paychecks unless employees proactively opt-out of the plan. Prior to passage of the Act, some states prohibited such deductions without an employee's affirmative election to participate.

### The Pros

Many say auto-enrollment is a long-overdue concept, noting that it is far too easy to put off signing up for an employer's 401(k) plan. Of particular concern are new hires, especially younger workers, who are often more focused on getting a paycheck than planning for retirement. Indeed, less than half of eligible workers in their 20s participate, according to industry statistics.

- **It's good for employees.** Yes, plan sponsors are “pushing” employees by automatically enrolling them — but certainly pushing them in the right direction from an ideological standpoint. In addition, research clearly shows that participants who are auto-enrolled tend to stay enrolled.
- **It offers protection for plan sponsors.** With automatic enrollment, the resulting dramatic increase in participation, in and of itself, significantly reduces the potential risk of the employer and the fiduciaries because it eliminates potential claims from people who did not get into the plan. Further, any employee who does not participate has to affirmatively file an election to get out of the plan. So, on top of high levels of participation, there is written evidence from every employee who opted out that the employee did not want to be in the plan.

## The Pros (continued)

- **It helps with discrimination testing.** Automatic enrollment also brings employees who might otherwise not participate (i.e., lower-paid workers who lack the savvy or motivation) into the fold. This helps with discrimination testing, which can be skewed toward more highly motivated, higher-income employees. In many cases, owners, managers and other highly compensated employees are impacted when lower-compensated employees don't participate and the plan fails either the actual deferral percentage (ADP) test or the actual contribution percentage (ACP) test. Then, a portion of the elective contributions of highly compensated employees may need to be either refunded or re-characterized as after-tax contributions.

## The Cons

However, this concept is not without its drawbacks. Auto-enrollment does raise important questions about the appropriateness and liability.

- **The potential for uncommitted participants increases.** By casting such a large net, automatic enrollment can result in plan participants who really aren't committed for the long haul. Sponsors tell of auto-enrolled employees who see that first deduction in their paycheck and immediately opt out, leaving very small balances that must still be administered (some plans allow those small amounts to be distributed).
- **The liability for matching contributions increases.** The flipside is that there are some employers who don't want to auto-enroll employees because it automatically increases the matching contributions for which they are liable.

## Factors To Consider

From a documentation standpoint, adding an automatic enrollment feature is fairly straightforward, requiring a simple amendment to your documents. But there are additional factors to consider.

**Make sure it's appropriate.** Auto enrollment tends to be more impactful and effective for manufacturing companies. In professional firms and white-collar companies, employees typically understand the value of the plan and already want to participate. But, auto-enrollment may not be appropriate for companies with a high percentage of "questionable workers," such as transient, seasonal or undocumented workers.

## Factors to Consider (continued)

**Establish eligibility.** A one-year waiting period is the norm, although some companies have made employees eligible for participation in as little as three months.

**Communicate and educate.** Under an automatic enrollment option, plan sponsors must make every effort to communicate with and educate employees about their options. Payroll staffers, 90-day notices, posters, employee meetings and the company intranet site should all be utilized.

## A Word About Default Investments

Understandably, some companies have shied away from auto enrollment, fearing lawsuits by participants if the investments chosen for the auto-enrollees should result in lost retirement savings.

Here, the Pension Protection Act creates safe harbor rules for selecting default investments. But, to get this protection, plans must follow specific Department of Labor guidelines—in particular, which investment options the DOL has sanctioned as qualified default investment alternatives (QDIA).

Under the guidelines, a QDIA must be one of three types to offer a rate of return that, over time, will generate adequate retirement savings. The investment objectives must consider the participant's age but not factors such as risk tolerances and other investment assets. The types of investment products include:

- A life-cycle or targeted retirement date fund or account.
- A balanced fund.
- An investment management service, which allocates assets to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures.

The Act also allows companies to shift liability to “fiduciary advisors.” Under this scenario, every participant would either be enrolled in the managed 401(k) service (liability shifted to the managed 401(k) provider) or they would have signed a document stating they have willingly taken on the risk of managing the account on their own.

## Parting Thoughts

Automatic enrollment has been shown to be remarkably effective in raising participation rates among eligible workers. The effects appear to be particularly promising for middle- and lower-income households, who have the greatest need to increase their savings.

A growing body of evidence suggests that the judicious use of default arrangements holds substantial promise for expanding retirement savings. Employees who fail to sign up for the plan — whether because of simple inertia or procrastination, or perhaps because they are not sufficiently well organized or are daunted by the choices confronting them — would become participants automatically.

If you would like to talk further about automatic enrollment to see if this would make sense for your plan, please call your partner or manager contact with our Firm and we would be happy to help you.

## **401(k) Highlight: Late Remittance of Participant Contributions**

The Employee Benefits Security Administration (EBSA) continues to focus on the timeliness of participant contributions in contributory employee benefit plans. DOL regulations require employers who sponsor pension plans to remit employee contributions as soon as practicable, but in no event more than fifteen business days after the month in which the participant contribution was withheld or received by the employer.

Failure to remit or untimely remittance of participant contributions may constitute a prohibited transaction, regardless of materiality. Plan sponsors faced with remitting delinquent participant contributions should consider utilizing the DOL's Voluntary Fiduciary Correction (VFC) Program. The program will lead an employer through the steps necessary to pay "lost earnings" on late deposits and will result in the DOL's issuance of a "no-action letter" and no imposition of DOL penalties. In addition, applicants could be eligible for immediate relief from payment of certain prohibited transaction excise taxes imposed by the IRS.

The DOL has conducted many investigations involving late remittances, often times triggered by the reporting of late remittances on the plan's Form 5500. It is not uncommon for the DOL to find additional late remittances that were not reported once they begin their investigation. Employers should be certain they are remitting employee withholdings promptly, certainly within the 15 business day threshold and earlier if at all possible.

Information regarding the VFC Program is available on the EBSA's web site at [www.dol.gov/dol/ebsa](http://www.dol.gov/dol/ebsa). Plan sponsors can telephone the EBSA regional office in their area with any questions about the application process. These telephone numbers may be found on the EBSA's website <http://askebsa.dol.gov/>. Employers not utilizing the VFC Program, are required to remit lost earnings to the plan as well as file form 5330, Return of Excise Taxes Related to Employee Benefit Plans, with the IRS to pay the 15% excise tax on the earnings on the late employee contributions and could be assessed additional penalties by the DOL.

If you would like to talk further about corrections to late remittances, please call your partner or manager contact with our Firm.

## **Fiduciary Responsibilities: 5 Ways to Minimize Your Liability**

Each employee benefit plan covered under the Employee Retirement Income Security Act (ERISA) is required to identify at least one person or entity as a “fiduciary.” Plan fiduciaries include any person or entity that exercises discretion in administering and managing a plan. That ordinarily includes:

- The trustee
- Investment advisers
- All members of a plan’s administrative committee (if it has such a committee) and those who select committee officials

Note that attorneys, accountants and actuaries generally are not considered fiduciaries when they are acting solely in their professional capacities.

### **Fiduciary Responsibilities**

Fiduciary responsibilities include:

- Carrying out duties prudently
- Following the plan documents (unless inconsistent with ERISA)
- Diversifying plan investments
- Paying only reasonable plan expenses

Fiduciaries who do not follow the basic standards of prudent conduct may be personally liable. For example, plan participants can bring suit against fiduciaries for performance losses and court costs. In fact, the number of court cases brought by plan participants is increasing dramatically, especially as participants become more sophisticated about investment performance and the benefits of diversification, and have immediate access to relative performance results.

In addition, the Department of Labor (DOL) and the IRS can audit a plan at any time. If the DOL finds fault with the management of plan assets, they can file suit against fiduciaries personally. The IRS can also disqualify the plan if it finds that the plan’s assets have not been managed for the exclusive benefit of the participants.

## Limiting Liability

Of course, a well-run plan provides benefits to its participants — and participants who are receiving adequate benefits are less likely to resort to litigation. But there are additional steps that fiduciaries can take to limit their liability.

**#1 Document, document, document.** ERISA standards revolve around a basic theme: documented prudence. Fiduciaries are rarely surcharged by the courts for poor performance results when investment decisions are prudently undertaken and properly documented. On the other hand, fiduciaries have been held liable for taking imprudent risks that resulted in losses or substandard performance when deficient documentation and/or poor procedures were followed in making the initial investment decisions.

*Takeaway: Demonstrate that you have carried out your fiduciary responsibilities by properly documenting the processes used to carry out those responsibilities.*

**#2 Diversify.** ERISA clearly states that a fiduciary must diversify the plan's assets. And the courts have been quick to find fiduciary liability when it was apparent that diversification did not exist and a loss occurred. Here, it is important to note that “asset allocation” and “diversification” are not synonymous. Asset allocation guidelines determine the distribution of assets among various investment classes to attempt to yield the greatest possible return consistent with the portfolio's risk parameters. Diversification is the risk-reduction process of choosing a broad range of different individual investments within a particular investment class. For example, if a fiduciary determines that 20 percent of assets should be placed in equities, then within that equity portfolio, assets should be diversified among a range of equity issues.

*Takeaway: Diversification objectives should be outlined in a well-thought-out Investment Policy Statement.*

**#3 Watch for conflicts.** Because of the high standard to which a fiduciary is held, the courts have been quick to find conflicts of interest (technically, “prohibited transactions”) when the fiduciary received “current economic benefit” from a transaction. Common prohibited transactions include the sale, exchange or leasing of land between the plan and the fiduciary (e.g., a physician who owns his professional building and sells the property to the plan). Foreign investments and loans from a plan to a plan participant (unless plan documents authorize loans and certain conditions are met) are also prohibited.

### **Limited Liability (continued)**

*Takeaway: A fiduciary should always be able to provide a satisfactory answer to the question, “As the plan fiduciary, do I stand to benefit or gain personally, either directly or indirectly, by the handling of the plan assets?”*

**#4 Consider bringing in the experts.** Because plan assets may represent the single most significant source of funds on which workers will depend during their retirement years, it is crucial that investment decisions be made with utmost diligence. It is for this reason that Congress, the IRS and the courts have strongly encouraged the appointment of professional investment advisors to manage plan assets. Here, fiduciaries may obtain a degree of protection from liability if the investment advisor has been prudently selected and monitored.

*Takeaway: Although you can reduce your liability by hiring an investment manager, you are still responsible for selecting a prudent investment manager and monitoring the manager’s performance.*

**#5 Monitor expenses.** ERISA requires the fiduciary to be responsible not only for developing an investment policy and selecting “prudent experts” to implement that policy, but also for ensuring that investment transactions are executed at the best cost, and that commission dollars pay for services that benefit the plan and participants.

*Takeaway: The U.S Department of Labor offers a downloadable 401(k) Plan Fee Disclosure Form on its website ([www.dol.gov/ebsa/pdf/401kfejm.pdf](http://www.dol.gov/ebsa/pdf/401kfejm.pdf)) that helps compare investment product fees and plan administration expenses charged by competing service providers, regardless of how a particular service provider structures its fees.*

### **Schedule Regular Reviews**

If the above procedures are followed, a fiduciary’s exposure to liability can be significantly reduced. The key is to prudently monitor either the asset manager you’ve selected or the performance of assets under your management. The review process should include:

- An overall assessment of performance
- Review of reports from the service provider
- Checking actual fees charged against proposals or engagement letters
- Following up on participant complaints.

### **Schedule Regular Reviews (continued)**

The results and documentation used in the review should then be maintained as evidence of the process.

### **Made A Mistake?**

The Department of Labor's Voluntary Fiduciary Correction Program (VFCP) encourages employers to voluntarily self-correct certain violations. The program covers 15 transactions, including failure to timely remit participant contributions and some prohibited transactions. In addition, the Department gives applicants immediate relief from payment of excise taxes under a class exemption. Similarly, the Department's Delinquent Filer Voluntary Compliance Program (DFVC) assists late or non-filers of the Form 5500 in coming up to date with corrected filings. For an overview of both programs, visit [www.dol.gov/ebsa](http://www.dol.gov/ebsa).

If you would like to talk further about ways to mitigate your company's liabilities with respect to your qualified plans, please call your partner or manager contact with our Firm.

## Employee Benefit Plans: Is Outsourcing the Easy Answer?

In today's competitive market it is common for Companies to outsource much of the administration of their employee benefit plans. Through carefully choosing capable and experienced 3<sup>rd</sup> party administrators (TPAs) and by establishing in-house monitoring procedures, management can reduce significantly the daily administrative duties relating to their employee benefit plans. In contrast, outsourcing to an ineffective TPA, without management closely monitoring plan activity, may actually open up the Company to substantially greater risk.

In the initial selecting of a TPA, management often performs extensive interviewing of qualified providers and carefully weighs many factors prior to making their selection. Unfortunately, after the conversion process is completed and the plan is being "seamlessly" handled by the TPA, it is not unusual for the plan sponsor to concentrate on other pressing areas of managing their business and to lose sight of the continued importance of monitoring the plan activity and the plan's TPAs.

In order to facilitate this monitoring process, many TPAs have subjected their operations to an independent review of their controls and procedures. This review is documented in a comprehensive report titled, *Report on Controls Placed in Operation and Tests of Operating Effectiveness*, commonly referred to as the SAS 70 Report. Contrary to management's common assumption that this is a report solely to be used by their plan auditors, this report is key to management's monitoring process. It provides a comprehensive narrative describing the control framework and system procedures, and a Type II report outlines not only the control objectives and the related controls, but the results of testing performed.

Of extreme importance to management is the section of the report that outlines user control considerations. Management needs to ensure that there are Company controls in place to address these areas identified in which the TPA is not assuming responsibility. Some of the more common areas where sponsor procedures are imperative relate to participant eligibility, vesting, timeliness and completeness of contributions and loans in default status. These key areas are often not subject to controls at the 3<sup>rd</sup> party administration organizations.

A common misconception is that all SAS 70 reports are the same. This is not the case. The TPA actually determines the scope of the report and can limit the independent auditor's testing to only those areas where they maintain strong controls and therefore totally exclude testing that could identify weaknesses.

## **Employee Benefit Plans - Is Outsourcing the Easy Answer? (continued)**

In an environment where not only the regulators, the Internal Revenue Service and the Department of Labor, are actively enforcing compliance with voluminous and complex rules, regulations and penalties, class action litigation suits are becoming the norm. Careful planning and establishing strong controls over the administration of your employee benefit plans will not only safeguard your employee's retirement assets, but will help mitigate your fiduciary exposure. This monitoring by management is so important that the AICPA Employee Benefit Plan Audit Quality Center just issued a Plan Advisory titled *Effective Monitoring of Outsourced Plan Recordkeeping and Reporting Functions*.

So is outsourcing the easy answer? Often times hiring an experienced TPA organization is the answer that makes both economical and practical sense. However, easy does not describe the monitoring process. It is imperative that management identify knowledgeable Company individuals that will continually monitor plan activity.

If you would like to talk further about how to ensure you or your TPA are fulfilling your fiduciary obligations with respect to your plan, please call your partner or manager contact with our Firm and we would be happy to help you.