hooker & holcombe

The value of benchmarking your retirement plan

Although benchmarking a retirement plan is not mandated, there are key reasons why this best practice is important. ERISA requires plan fiduciaries to ensure that expenses are reasonable, so plan sponsors must monitor expenses to keep them in check and to ensure that the services provided are carried out effectively.

Plan sponsors also have a fiduciary duty to participants – they must ensure that all fees paid by the 401(k) plan are reasonable to protect the interests of plan participants, thus limiting fiduciary liability. The Department of Labor, however, does not define what is considered reasonable, so plan sponsors must make this determination. Benchmarking a plan is an efficient way to do so.

Accounting for changing needs

Benchmarking is like trading in a car. When we're young, most of us buy an affordable, reliable car without the bells and whistles. As we get older, perhaps we land a new job with a long commute, so comfort is important – bring on that sunroof! A few years later, there's a spouse and kids in the picture, so we need more space and safety (an SUV, perhaps?), with a dropdown TV screen thrown in for good measure. You may question the expense of the TV screen, but that little detail is worth it because those car rides to Grandma and Grandpa's are long and kids aren't going to nap. Likewise, the retirement plan an employer started with may not always fit what the company and plan participants need as the company matures.

One major issue is a low percentage of small to mid-sized employers are very familiar with their retirement plan fees. Many plan sponsors wear multiple hats, and don't have the time to needed to manage the plan. Some choose to leverage an expert to benchmark the plan and help ensure that costs, features, and services remain competitive.

Seeing the Big Picture

In this day and age, many plan sponsors tend to benchmark only plan costs, but the range and quality of services are also important. That luxury SUV is more expensive than your four-cylinder starter car, but does that make it a bad choice? The point of this process is to look at the whole picture, so you can accurately assess what the plan offers to employees and then determine what may need updating for a better fit. In many cases, as a company matures and grows, updating plan features and improving the quality and scope of participant-related services makes a lot of sense.

Plan costs and expenses. Over time, due to market growth and ongoing contributions, assets in most 401(k) plans are continually growing. As the assets grow, the various fees involved likely increase proportionately as well because many service providers do not automatically adjust their fees. The reality is that as plan assets grow in size, costs as a percentage of assets should fall. Benchmarking a retirement plan is a great way to help determine if fees need to be renegotiated, or if it's time to shop for new service providers.

Plan design. You should consistently review plan design and features for opportunities for improvement. This can include the terms in the plan document, auto-enrollment and escalation, or Roth features. Your recommendation to add new features could help position the company's benefits package more competitively.

Services. As a company continues to mature, so do the needs of its retirement plan. Companies often must make decisions about what services they need to support their business, so why should a retirement plan be any different?

For example, a 3(21) fiduciary advisor makes investment recommendations to the plan sponsor, but ultimately the investment decisions fall on the plan sponsor. A 3(38) fiduciary advisor assumes full control for the investment decisions, therefore offloading some of the plan sponsor's fiduciary responsibility. Both services have different price points, with a 3(38) fiduciary advisor typically carrying a greater cost. But if the plan sponsor is looking to offload the burden of making investment decisions, the cost may be justified.

A partner for your business

Like buying a car, benchmarking a retirement plan takes time, thoughtful consideration of expenses, and an understanding of each purchaser's individual needs. By breaking down the process into steps, plan sponsors can understand how their plans measure up to others in their industry while helping to ensure that they are fulfilling their fiduciary responsibilities to the plan and its participants.