Arnerich Massena
2045 NE Martin Luther King Jr. Blvd.
Portland, OR 97212
503.239.0475
www.arnerichmassena.com

Retirement Plan Best Practices
Plan Monitoring

Fourth of five-part series

Arnerich Massena, Inc.

February 2018

Contributors:
Ryan Cunningham, CAIA; Jillian Perkins;
Terri Schwartz; Chris Van Dyke, CFA, CAIA

This paper is the fourth in Arnerich Massena's five-part series on retirement plan best practices. The full series covers retirement plan best practices in the following areas:

- Plan Governance
- Plan Design
- Investment Menu Construction
- Plan Monitoring
- Participant Education

Table of Contents

Plan Monitoring

The first three papers in this series covered plan governance, plan design, and investment menu construction, providing the foundation for building a retirement plan that follows best practices and serves participants. The next step for plan sponsors is to monitor the plan and ensure that it continues to meet its objectives.

Maintaining an employer-sponsored retirement plan is an ongoing process, requiring dedicated attention and oversight. Monitoring your investment menu managers, your plan providers, and plan fees is an important part of your overall fiduciary responsibility. Plan sponsors vary widely in how they monitor their plans. What are best practices, and what standards should you be following in your monitoring practices? In this paper, we'll look at best practices for:

- Reviewing performance and other data of your investment menu managers
- Managing your plan providers and best practices for conducting an RFP and negotiation process
- Benchmarking your plan providers
- Assessing, monitoring, and benchmarking plan fees

Fiduciary liability often comes down to process more than outcome. Have you set up a prudent monitoring process for your plan, and are you following that process? Are decisions being made according to that process? To demonstrate fiduciary prudence, it is critical to document the process you intend to follow as well as the process itself as you conduct it, keeping careful records of decision-making at all stages. Throughout this paper, you'll find checklists that may be helpful in building and maintaining your plan monitoring processes.

Monitoring investment funds and managers

Reviewing fund lineup performance is at the top of the list when it comes to monitoring the plan. The investment menu, once constructed, needs to be continually reviewed and evaluated. Reviewing performance is important, of course, but plan sponsors should be looking at an array of factors to ensure that the funds in their lineup continue to meet their participants' needs and fit into the investment menu.

Funds and performance should be carefully reviewed at least quarterly. It's important to keep in mind that short-term performance fluctuations should not be the sole focus of these reviews, which should be conducted to maintain ongoing consistent review of the plan's investment options and to document that review. Plan sponsors may opt to choose a discretionary, or 3(31) arrangement with their consultant, in which case this review is generally performed in an ongoing manner by the consultant on their behalf. Otherwise, the investment committee should participate in the review, guided by the plan's investment consultant.

The quarterly review should include an in-depth look at a variety of issues:

Performance: While performance should be reviewed each quarter, it's important to keep a long-term perspective and look at performance over full market cycles rather than short-term ups and downs. Managers in an investment menu should be selected to fill a designated purpose, and performance should stay consistent with that purpose. Review the market environment, market drivers, sector performance, and other factors that may affect fund performance in order to provide additional perspective.

Manager changes: Are there any major changes taking place in your investment managers, such as staff changes, mergers or acquisitions, or significant changes in assets? This can impact the manager's ability to continue fulfilling the purpose identified when they were selected for the investment lineup.

Overall lineup: While you will analyze the menu structure and lineup more in-depth during the initial selection phase, it's wise to continue to review it periodically to ensure that it is meeting your plan objectives. Are participants using all of the options? Does the menu offer adequate diversification, and do the funds work well together? Are you providing your participants with tools like target-date funds?

Fees: We'll talk more about monitoring and benchmarking fees later, but the quarterly fund review should include a look at fees to ensure ongoing reasonableness.

This quarterly review should be well documented in meeting minutes that include any actions or decisions taken. Use the checklist on the following page to guide your process and help ensure a comprehensive review and discussion.

PLAN PROVIDERS

Fortunately, you have partners to help manage your plan, including your plan recordkeeper, plan investment consultant, and any other providers you may work with. As a fiduciary, you have a responsibility to monitor these providers and ensure that the services they render are meeting the needs of the plan at a reasonable cost. You must be able to show that you have engaged in meaningful analysis and comparison of your providers and their fees.

The committee should conduct an annual review of each provider. At this time, the committee should review the provider contract to make sure all terms are being met. Additionally, review the provider's overall service structure and evaluate the service provided in the context of the participants' needs. It can be helpful to have your providers put together a short presentation to walk through their services, giving the committee context for the evaluation. Be sure to address the following questions and identify any issues or challenges:

- Are the services continuing to meet the needs of your plan and participants?
- Is it a reasonable level of service for the cost?
- Are there services that you feel are lacking, or services that are not included but which participants might benefit from?

Investment Line-up Review Checklist

Overall fund lineup

- ☐ The lineup provides adequate options for diversification.
- ☐ There are options suitable for your participants' level of sophistication.
- ☐ The funds work well together.
- ☐ The menu is constructed in an easy-to-use manner.

Performance

- ☐ Fund performance is in line with expectations.
- ☐ Are there any significant deviations that require attention?
- ☐ Are there any funds that have been consistently underperforming?

Managers

- ☐ Have there been any change to senior staff members?
- ☐ Are the managers consistent in their philosophy and approach?
- ☐ Have there been any significant changes to assets under management that might affect the fund?

Fees

- ☐ Are the fees reasonable for the type of fund?
- ☐ Are you in the lowest-fee share class available?
- ☐ How do the fees compare with plans of similar size?

In addition to an annual review, plan sponsors should consider undergoing an RFP or RFI process periodically. Depending on the provider and plan sponsor, we generally recommend engaging in an RFP process about every three to five years. While not regulatorily essential, issuing a vendor RFP has tremendous benefits and demonstrates a high degree of fiduciary prudence. The RFP process can help you determine whether your provider is giving you an optimal level of service for the price being charged and can either validate that your current partner is the best fit or indicate if this is not the case.

Conducting a full RFP process has many benefits, including:

- Maximizing cost savings for plan participants: An RFP places your organization in a strong negotiating position and can spur vendors to be more competitive.
- Providing documentation of the execution of prudent fiduciary practice. Periodic RFP searches document the ongoing evaluation of your providers, taking into account current market conditions and any growth of plan assets.
- Assisting committee members in familiarizing themselves with best practices from the top providers in the industry in order to potentially implement some of these practices for the benefit of participants.

A successful RFP process depends largely on preparation and organization. Identifying your goals and objectives, setting minimum qualifications, prioritizing scoring criteria, and defining the project timeline will set the stage for a positive outcome. Consider enlisting help with the RFP process — having a third-party organization run and manage the details can allow the committee to focus on evaluation and decision-making. Use the checklist on the following page to help construct and score your RFP.

The RFP construction will impact the responses you receive. There are a variety of tools and templates that can help, as well as using third-party assistance. When crafting your RFP, following are a few things to keep in mind:

- Communicate your expectations; by narrowing the expected scope of service, you will achieve a more level comparison.
- The more you customize the RFP to your plan, the more relevant the information you will receive. Provide information about your plan to encourage responses that are specific rather than general.
- Allow some flexibility in the service model to allow providers to make recommendations and offer services they believe may be relevant. Consider including an "additional services" section, in which providers can outline the services they would offer outside of those requested in the scope of services.
- Mitigate the potential for surprise fee modifications by including all pertinent information and covering the details of the plan.

With good preparation and organization, the evaluation period can be a smooth process. Keep the finalist interview process efficient by limiting the finalists only to those who have a legitimate chance of winning and by preparing an agenda in advance. Identify areas of weakness in each proposal and offer vendors the opportunity to make improvements and refinements to their proposals in advance of the finalist interviews.

Recordkeeping RFP Checklist

Preparation

- ☐ Set minimum qualifications
- ☐ Identify key constituents
- ☐ Identify goals & objectives
- ☐ Select your field of providers

Identify and prioritize scoring criteria: Areas of evaluation

- ☐ Firm background
  - Client base
  - Experience
  - Financial status
- ☐ Participant services
  - Communication and statements
  - Web interface
  - Phone services
  - Education and communication
- ☐ Plan sponsor services
  - Support
  - Technology
  - Process automation
  - Web tools
- ☐ Investment flexibility and capabilities
  - Open architecture capability
  - Fund implementation capability
  - Fund implementation timing constraints
- ☐ Fees and expenses
  - Recordkeeping
  - Investment fees
  - Other fees
  - Fee transparency
- ☐ Transition/conversion
  - Transition planning
  - Transition monitoring
  - Quality control and testing procedures
  - Implementation communication

As you select and monitor your plan providers, remember that you are working on behalf of the plan participants. All decisions should be made based solely on their best interests; considerations that are unrelated to the plan — such as a vendor who reduces fees on other business services or offers a board member's son a job — cannot be allowed to influence or even appear to influence the selection. And, of course, retain careful documentation of your process.

Plan Fees

In Figure 1, you can see how a small difference in fees can impact a participant's retirement savings over time — a 50 or 100 bps difference in fees can result in many fewer years of retirement income. Because plan and investment fees can have such a significant impact on participants' ability to grow their savings, they are a critical issue for the committee. A diligent plan for monitoring fees demonstrates fiduciary prudence, but also helps ensure that plan fees are consistently reasonable and that participants are getting the most for their money.

While keeping a constant eye on fees, the committee should complete an in-depth fee review at least annually. This review should include plan and administrative fees as well as investment fees, so that the committee is able to see both an overall and detailed view of what participants are paying. In order to be effective in reviewing costs, the committee needs to have a strong understanding of the plan's fees and how they are structured. The plan's providers should be available to assist in this process, as it can be complicated and daunting.

Managing and monitoring plan fees is a delicate balancing act. The goal should not be to achieve the lowest possible fees; mind the caveat that "you get what you pay for." Rather, the objective is to build a plan and investment menu singularly suited to your participants and then make sure that the fees are commensurate with the services participants receive. This is true for both administrative and investment fees; the committee's

Plan Administrative Fee Checklist

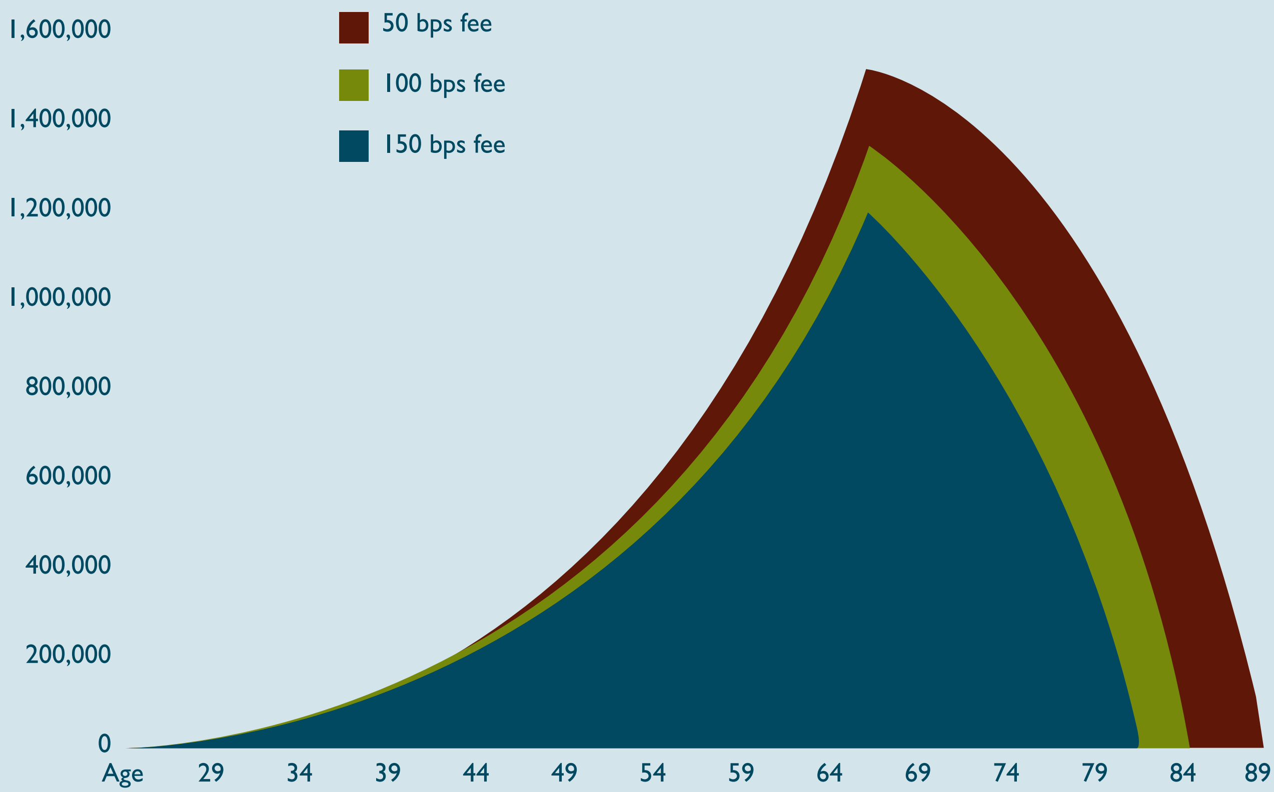
- ☐ How are fees structured? Are they fairly distributed across participants?
- ☐ Are fees in line with plans of similar size and services?
- ☐ What is the overall impact of fees on participant retirement savings, and is it reasonable?
- ☐ For what services, if any, do participants pay additional fees?

Plan Investment Fee Checklist

- ☐ Are the plan's investments' expense ratios reasonable and in line with industry averages?
- ☐ Are the expense ratios commensurate with the types of funds (i.e. active versus passive, U.S. versus international)?
- ☐ If any investments engage in revenue sharing, are those participants paying a greater proportion of the plan's administrative costs as a result?

Figure 1: How plan and investment fees affect long-term participant outcomes

The hypothetical participant in this chart starts saving at age 25 and saves 10% of her annual salary, which starts at $50,000 and increases by 3% annually. She earns an annual return of 7.0% up until retirement, and 5.5% after retiring at age 67. She replaces 50% of her pre-retirement income in retirement.



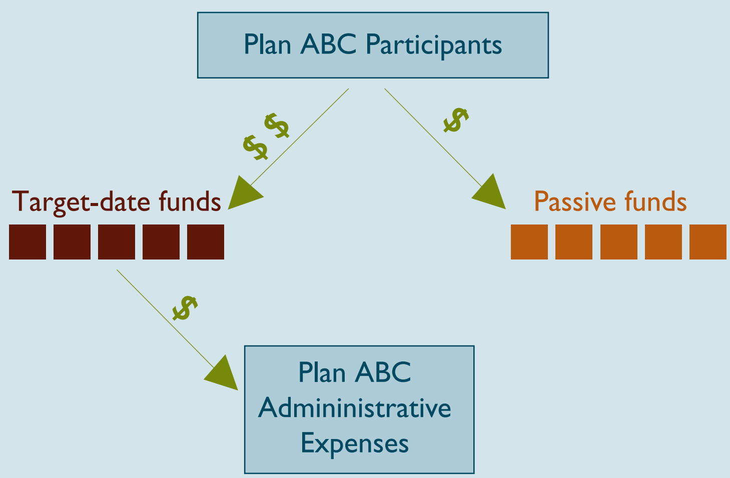
task is to both keep costs down and manageable, but mostly to make sure the costs are reasonable given what participants receive for their expenditures.

In addition to monitoring administrative fees, plan sponsors should be reviewing the plan's investment management fees as well. As with administrative fees, the objective is not to seek out the lowest expense ratios, but to ensure reasonableness. In reviewing fees, plan sponsors should look at investment fees in the context of the types of funds they cover. Active funds are likely to be more expensive than passive funds, due to the additional costs of active management. International fund fees are typically higher than expense ratios for domestic funds, as conducting research internationally may incur greater costs. Specialty funds may also have higher fees. Compare each fund's fees to its peers to establish a basis for assessing reasonableness.

In the next section, we'll talk about benchmarking your plan.

One element of fee review worthy of an additional note is the concept of fee equality. Some fee structures create significant disparities in how much one participant pays versus another. For instance, consider this scenario (illustrated in Figure 2 below): a hypothetical plan, Plan ABC, offers a set of target-date funds and a line-up of passively managed funds. In this hypothetical example, the target-date funds have a higher expense ratio but return a portion of the investment management fees back to the plan sponsor via a revenue sharing arrangement, which monies are then used to pay Plan ABC's administrative costs. The passive funds do not have any revenue sharing associated with them. The end result of this arrangement is that those participants who invest in target-date funds pay all of the plan's administrative expenses, while participants who build a portfolio from the passive funds pay no administrative expenses at all. Participants have no clear way of knowing which funds pay revenue sharing, nor do they necessarily understand the difference. Ultimately, though, because the administration of the plan benefits all participants, this unequal weighting of fees is unfair.

Figure 2: Hypothetical Example: Plan ABC



Unfortunately, this type of scenario is quite typical, meaning that it is worthwhile for plan sponsors to examine the possibility of fee equalization. Despite a lack of regulatory pressure in this area (yet), we consider fee equalization to be a fiduciary best practice. Assuring fairness of fees is part of the fiduciary responsibility to serve the best interests of all participants and act as caretaker for their retirement plan.

One way to achieve fee equalization is to eliminate revenue sharing arrangements altogether, a path that more and more plan sponsors are choosing to take. However, as a fiduciary, you may not want the share classes available to drive your decisions about fund selection; it should be only one of many factors you evaluate when selecting funds for the lineup. For plan sponsors who cannot eliminate revenue sharing, fee equality is still possible. Some recordkeepers are able to equalize fees through a system of proportionate credits and charges, or can simply rebate revenue sharing fees and charge administrative fees as a separate line item.

Another level of fee equalization is to look at how administrative expenses are charged to participants. Flat fees tend to penalize those with small account balances, while asset-based fees may be onerous to participants with large account balances. Examining how your fee structure affects participants in different situations can help you determine the best way to embed consistency and fairness into the system. For example, charging an asset-based fee up to a maximum, using a tiered asset-based fee, or setting up a combination of flat fee and asset-based fee may be ways to improve fee equality.

Plan Benchmarking and Fee Analysis

One of the best ways to demonstrate fiduciary prudence in the monitoring of your plan is to benchmark your plan against peers of similar size and/or the industry as a whole. A comparison of your plan against other, similar plans can provide a context against which to evaluate your plan's design and features, and can help highlight any areas that may be lagging or that need attention. Similarly, conducting an analysis of your plan's fees against industry averages shows you how your fees compare relative to other plans. We recommend as a best practice to prepare a benchmarking report and fee analysis of your plan every two to three years.

Your plan providers may be able to assist in compiling the data needed for benchmarking and fee analysis. You can also look to industry surveys, which often provide a wealth of information about defined contribution plan design and data.

In addition to benchmarking your plan against peers, it may be useful to benchmark your plan against the objectives you've set out for it. For instance, are participants using the plan features? Are you meeting participation goals, and are participants contributing enough? Are they adequately diversified? You can examine the range of participant returns, balances, and other plan data to assess whether the plan is continuing to meet the needs of your participants and serve the purposes you have identified for it.

The plan benchmarking checklist on the following page is designed to serve as a guide to the areas of plan design and data you may want to evaluate and compare in your benchmarking process. It is by no means exhaustive, and of course trends will change over time. Customize your benchmarking process to your plan's unique needs and objectives.

Plan Benchmarking Checklist

Enrollment, participation and contribution rates

- ☐ What are the plan's eligibility requirements?
- ☐ What is the participation rate?
- ☐ What is the average deferral rate?
- ☐ What is the median balance?

Employer contributions

- ☐ Do you offer matching contributions?
- ☐ What is your match formula?
- ☐ What service requirements must be met before an employee receives matching contributions?
- ☐ What is the plan's vesting schedule?

Automatic features

- ☐ Does your plan make use of automatic enrollment?
- ☐ Does your plan implement automatic contribution increases?

Investment menu

- ☐ How many investment options are on the plan's investment menu?
- ☐ Does the lineup include:
  - ☐ Target-date funds
  - ☐ Active and passive options
  - ☐ Growth and value options
  - ☐ Company stock
- ☐ What is the participation use rate of each option?
- ☐ What are participants' asset allocations?
- ☐ Is the plan using the lowest-fee share classes possible for each option?

Additional options: Roth option, managed accounts, retirement income solutions, brokerage window

- ☐ Do you offer a Roth option, managed accounts, retirement income solutions, and/or a self-directed brokerage window?
- ☐ What is the participant adoption rate of each of those features?

Additional features

- ☐ Does the plan offer loans?
- ☐ What are the plan's withdrawal and distribution options?
- ☐ How many retired participants are in the plan?

Education, Advice, & Communication

- ☐ Do you provide investment advice?
- ☐ Do you provide investment and retirement planning education?
- ☐ How robust is your program of education? Do you provide in-person education, online resources, printed resources? Is your program customized to your plan?

Conclusion

ERISA enjoins plan sponsors with a "continuing duty to monitor" plan investments, making it clear that building the plan and selecting the investments is not the end of a sponsor's fiduciary duty. We believe that best practice calls for close monitoring of the plan's investments, fees, and other features regularly. The act of monitoring itself demonstrates a degree of fiduciary prudence when the sponsor follows a well-documented process. Often, when plans fall short of their fiduciary responsibilities, it has less to do with outcome and more to do with failing to follow a process or maintain adequate documentation of such. Setting forth the monitoring process and then documenting it as you follow it is a best practice for showing that you are fulfilling your duties as a fiduciary.

We hope you find the checklists in this paper helpful as you design your monitoring process and procedures. Work with your plan's providers and partners to conduct ongoing review and monitoring of your investment lineup, fees, and plan design. And additionally, establish and maintain a monitoring process for your providers.