SELECTING VENDORS FOR YOUR DEFINED CONTRIBUTION PLAN

Individuals responsible for their company's qualified retirement plan face numerous difficult decisions when selecting plan service vendors. As technologies change, and as plan sponsors seek to shift additional responsibilities to external vendors, the complexity of the assignment increases. In selecting providers for the plan, each vendor's fees, capabilities and experience must be assessed in each of several key areas, including:

- Administrative, recordkeeping and trust service capabilities;
- Access to high quality funds;
- Ability to insulate you and your company from fiduciary liability; and
- Employee communications and investment education capabilities.

When many companies consider changing plan service providers, the question inevitably becomes: "What vendor should we select to assist with the operation of our plan?" Given the increasing popularity of bundled service arrangement, it is natural that the question is frequently framed in this manner. However, for a service solution to be truly appropriate for the plan sponsor, the service selection question should be parsed into its component elements:

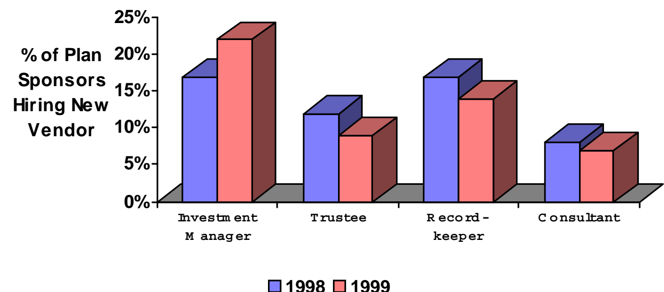
1) What investment structure (or combination of structures) is most appropriate for our workforce?
2) What type of administrative configuration can most effectively deliver the services necessary to support the selected investment structure(s)?
3) Which vendor or vendors should be selected to deliver desired services, such as:

- Investment management;
- Trusteeship;
- Recordkeeping and administration;
- Employee communications;
- Participant level investment education and/or advice;
- Compliance consulting and plan documentation; and
- Investment consulting and advice for the plan sponsor.

Many plan sponsors find that a bundled provider's capabilities will support most of their needs in each of these various categories. Other sponsors find that unbundled arrangements offer more customized capabilities at a total cost comparable to or lower than the comprehensive fee proposed by the bundled providers. By identifying their company's key priorities, and rigorously evaluating each vendor's capabilities to support their unique needs, plan sponsor's can ensure that the vendor selection process leads to a robust and lasting plan support solution.

Avoiding the "Sales Claims" Trap

Many plan sponsors make frequent changes to their service vendors. A recent survey shows that in 1999 alone, nearly one-half (47%) of 401(k) plan sponsors intend to change at least one service provider. Overall, 64% of plan sponsors will retain a selected provider for five years or less.



Source: BARRA Rogers Casey/IOMA 1999 Defined Contribution Survey

This high turnover suggests that many plan sponsors have unrealistic expectations. Sponsor expectations are generally created during the service provider's sales process. Thus the key to successfully evaluating any plan service vendor is the ability to distinguish sales claims from service capability.

Vendor Selection Process

One conclusion that might be drawn from these turnover statistics is that many plan sponsors adopt a flawed vendor selection process. The Department of Labor's ERISA Advisory Council seems to agree with this conclusion. In their Report of the Working Group on Guidance in Selecting and Monitoring Service Providers, the Advisory Council writes:

> *Many of the problems with respect to service providers arise because the responsible fiduciary either does not understand his role and responsibility in the selection and monitoring of service providers or exercises poor judgement because he does not have experience or an*

"Many of the problems with respect to service providers arise because the responsible fiduciary either does not understand his role and responsibility in the selection and monitoring of service providers or exercises poor judgement because he does not have experience or an appropriate source of information concerning legal requirements and industry practices.."

appropriate source of information concerning legal requirements and industry practices.

A plan sponsor can ensure that their retirement plan investment and administrative structures are supported by appropriate vendors, and correctly matched to their employee population and service needs, by implementing these ten steps:

1) ***Review*** the range of investment and administrative service configurations available for the plan;
2) ***Determine*** how the investment configuration selected for the plan will impact the plan sponsor's ongoing fiduciary responsibilities;
3) ***Evaluate*** the extent of employees' investment expertise, and their ability to learn from an investment education program;
4) ***Decide*** which service configuration best meets the employees' ability to manage investments and the sponsor's objectives for liability relief;
5) ***Identify*** vendors that offer services in the preferred configuration;
6) ***Solicit*** proposals from service providers, using a structured service and pricing template;
7) ***Evaluate*** proposals, focusing on how well provider capabilities match employer and plan objectives;
8) ***Select*** and interview finalists (generally two to four entities);
9) ***Notify*** selected vendor(s) and develop a transition workplan; and
10) ***Implement*** an education program to support the selected investment configuration.

Steps 1 through 4 will help ensure that providers considered offer services appropriate to the needs of the plan sponsor's workforce. For example, a sponsor might be considering a proposal from a provider that specializes in offering self-directed brokerage accounts and a sophisticated investment education program. However, the sponsor may be aware that much of its workforce is overwhelmed by the current range of investment options, and that employees seek a simplified method for making investment decisions. Although the provider's capabilities for supporting brokerage accounts may be impeccable, these qualifications are irrelevant to most of the participants in the plan. Consequently, the provider would be an inappropriate choice for this particular plan sponsor.

Steps 5 through 8 will help the plan sponsor identify a vendor whose capabilities match appropriately to the unique needs of the sponsor's employees. Steps 9 and 10 are required to appropriately manage the transition to the new vendor.

SELECTING INVESTMENT AND SERVICE CONFIGURATIONS

Generally there are three primary investment structures from which the plan sponsor may select: ***menu of funds, diversified portfolio and unrestricted***. Additionally, plan administrative services are offered in three primary configurations: ***bundled; alliance and unbundled.*** A single administrative service configuration may include multiple investment structures.

The primary administrative investment structures and administrative service configurations are described below:

Investment Structure	Primary Characteristics
Diversified Portfolio (Tier 1):	Provides a range of diversified portfolios managed to meet various risk/ reward targets. Participant generally chooses just one portfolio that is most appropriate for their retirement objectives and/or current economic circumstances.
Menu of Funds (Tier 2):	Set selection of investment choices. Participants create their own portfolios by combining funds from the designated menu. In a closed menu plan, all funds are from a single company; in an open menu plan, funds may be offered from several unrelated investment providers..
Unrestricted (Tier 3):	Permits participants to purchase any legally permissible investment, through a brokerage account.

Although historically, the menu of funds approach has been the most popular investment structure, both diversified portfolio and unrestricted approaches have recently experienced increasing popularity. Plan sponsors find that their workforce includes employees

One of the key decisions that the plan sponsor faces is whether to bundle all plan services with a single provider, or to separately engage specialist providers for each required plan function.

with varying degrees of investment expertise. More sophisticated investors argue that the range of choice available in a typical menu plan restricts their ability to construct truly customized portfolios. Less sophisticated investors may be overwhelmed by the decisions required to select investments from even a moderate range of menu options. Consequently, many plan sponsors are adding unrestricted accounts to menu plans to satisfy the needs of sophisticated investors without excessively complicating the basic menu. Additionally, some plan sponsors believe that some employees need help making basic investment decisions. Many of these sponsors are adding diversified portfolio options. Thus, more plans are incorporating all three investment approaches. Some sponsors refer to these comprehensive arrangements as "three-tier" plans. Tier one refers to diversified portfolios, generally catering to less sophisticated investors. Tier two refers to the menu of funds, from which more sophisticated investors construct their own portfolios. Tier three refers to the unrestricted accounts used by the most experienced investors.

Service Configuration	Primary Characteristics
Bundled:	Structured combination of trustee, recordkeeping, and investment management services. Usually includes a relatively structured set of available plan provisions, recordkeeping reports, funds, etc. In an integrated arrangement, the bundling vendor provides all services; in a contracted arrangement some administrative services may be rendered by third parties.
Alliance:	Similar to the “Unbundled” system: Features separate trustee, recordkeeper, and investment management vendor(s). Service providers work together regularly, and generally use electronic interfaces to pass plan information between entities. Usually characterized by specialty expertise and sophisticated technology. Investments may subsidize administrative costs.
Unbundled:	Features separate trustee, recordkeeper, and investment management vendor(s). Vendors are selected separately. Features maximum flexibility for the sponsor in designing plan provisions and selecting and replacing service providers, but may not provide streamlined administration.

Bundled or Unbundled?

One of the key decisions that the plan sponsor faces is whether to bundle all plan services with a single provider, or to separately engage specialist providers for each required plan function. Recently, more plan sponsors seem to be choosing the bundled approach. According to surveys by Access Research, Inc., a Connecticut based retirement-plan research firm, 61% of the 248,000 plans in place at the end of 1996 were fully bundled, up from 50% at the end of 1991. Conversely, Timothy Murphy, a 401(k) consultant with Hewitt Associates opines: "There's definitely more unbundling of 401(k) [services] going on today." This perception may depend on the size of market being discussed. An IOMA study reports that more than half of the sponsors of very large (more than 10,000 participants) use unbundled arrangements, and that these sponsors are more satisfied with the quality of service and tend to maintain relationships for longer time frames. Perhaps the unbundled providers have sufficient budgets to commit resources to support these larger plans in a manner that is not cost-effective for smaller plans.

FIDUCIARY RESPONSIBILITY FOR VENDOR SELECTION

Vendor selection is a fiduciary responsibility under ERISA. Fiduciaries are responsible for operating the plan solely for the benefit of plan participants and beneficiaries, and can be sued by participants, beneficiaries and the Department of Labor for not adequately fulfilling their fiduciary responsibilities.

In selecting vendors for their plans, plan fiduciaries face two primary pitfalls:

- poor or inadequately documented selection of investment providers; and
- lack of appropriate distinction between administrative service pricing and capabilities, and investment management pricing and capabilities.

Both pitfalls generally stem from the fact that most sponsors focus on selecting a specific provider too early in the process. Most large bundled providers have competent and aggressive sales executives who are eager to demonstrate their organization's capabilities.

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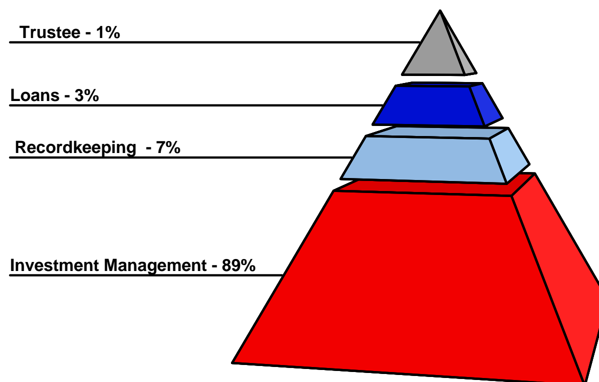
Cross-subsidization of administrative services has developed to the extent that for many vendors in the mid- and large plan market, the nominal price for recordkeeping and trust services is zero. With the opportunity to eliminate all out-of-pocket costs, and to take advantage of the latest service package offered by the bundled providers, many sponsors jump immediately from basic fact finding to vendor selection.

Unfortunately, such rapid decisionmaking may inadvertently omit consideration of some of the most important cost factors. In a pamphlet directed to 401(k) plan participants, the Department of Labor (DOL) reports: "By far the largest component of 401(k) plan fees and expenses is associated with managing plan investments...You should pay attention to these fees. You pay for them in the form of an indirect charge because they are deducted directly from your investment returns." A study by the Institute of Management and Administration (IOMA) quantifies the PWBA's assertion, finding that investment management fees represent almost 90% of the total operating costs for a typical 500 participant 401(k) plan.



To avoid these pitfalls, we recommend that sponsors implement a less traditional selection approach. Rather than initially focussing on vendor selection, start by focussing on investment structures. What range of investment options would be most appropriate for the unique needs of your workforce? Then investigate administrative capabilities. What services are essential for the effective administration of your plan? What frills would be nice to have, but are not essential? How do various providers match up in offering these services? Then, start comparing fees for administrative services, remembering that an accurate comparison of total plan cost can't be made until investment funds have been selected.

To understand that interrelationship between selecting an investment structure, selecting an administrative configuration, selecting a vendor and selecting investment funds, let's review some of the basic responsibilities that apply to plan fiduciaries, and how they apply under various different scenarios.

Responsibility for Prudent Investment Selection

In very general terms, fiduciaries must be sure that their plan complies with the general prudent investment standards established under ERISA section 404(a). If the plan permits employees to choose how their account will be invested, fiduciaries must also be sure that their plan complies with the participant direction rules established under ERISA section 404(c).

Section 404(c) and Participant Directed Accounts

Department of Labor regulations under Section 404(c) of ERISA outline the requirements employers must meet in order to avoid being held responsible for their employees' investment decisions. The regulations establish basic standards under which employees are deemed to control the investment of assets in their own accounts.

Diversified Portfolios (Tier 1)

Diversified portfolio structures (which may include known as "life style" or "life cycle" investments) offer participants a range of choice without requiring that the plan fiduciaries adhere to the 404(c) requirements. Briefly, each diversified portfolio represents a balanced account that is both prudent and diversified. The plan fiduciaries then select or construct several managed portfolios with varying investment approaches, from conservative to aggressive. The plan participant cannot make an imprudent investment selection, since each portfolio is designed to be implicitly prudent. As such, these portfolios offer sponsors a separate path to compliance with fiduciary responsibility through conformity with the general 404(a) requirements and the "Prudent Person" investment rules.

Most commentators believe that unrestricted investment structures satisfy the Section 404(c) regulations. They argue that fiduciaries are insulated from liability due to adverse investment performance in participant accounts simply because there are no constraints or limitations put on plan participants' ability to select their investments.

Although most bundled providers make available some "life style" mutual funds, very few bundled providers permit plan sponsors to construct their own customized diversified portfolios. Further, the "life style" mutual funds offered by many bundled providers may be expensive, poorly constructed and difficult to defend under the general prudence standard of ERISA Section 404(a). An appropriately structured diversified portfolio program offers participants options representing efficient trade-off of risk and return. To provide such an option, many sponsors choose to construct their own customized diversified portfolios, often using the mutual funds selected for the plan's menu program. Since bundled providers rarely support this type of program, these custom arrangements are typically offered through an alliance or unbundled administrative structure.

Menu Plans (Tier 2)

In a menu plan, fiduciaries select a series of funds. Each fund generally represents a designated asset class or sub-asset class. Plan participants then select funds from the menu to construct their individual plan portfolio.

Menu plans are generally designed to comply with ERISA section 404(c). Although not a "safe harbor," 404(c) compliance indicates that the plan offers a diversified menu of investment choices with a sufficiently broad range of risk/return characteristics such that participants can implement an appropriate portfolio. Likewise, it indicates that the employer has provided each participant with investment information (including account statements) sufficient to allow for timely and well-informed investment decisions

Section 404(c) does not relieve fiduciaries from their general responsibilities codified in section 404(a). These include:

- selecting appropriate investment options to make up the plan menu;
- monitoring the performance of the selected investments to determine ongoing prudence; and
- evaluating all costs which impact investment performance.

Unrestricted Investment Structures (Tier 3)

Most commentators believe that unrestricted investment structures satisfy the Section 404(c) regulations. They argue that fiduciaries are insulated from liability due to adverse investment performance in participant accounts simply because there are no constraints or limitations put on plan participants' ability to select their investments. Other experts disagree, arguing that sponsors retain the responsibility to ensure that participants prudently use the unrestricted structure. Regardless of the resolution of this debate (which will eventually be decided in court), fiduciaries for plans with unrestricted investment structures still face several significant concerns:

- Costs charged to participant accounts must be reasonable. In an unrestricted structure, each participant generally pays a flat annual account fee for the brokerage account, and all trading costs. Although these fees may be small relative to large account balances, they may represent a significant drag on earnings for small accounts.
- The accounts must be structured to prevent impermissible or inappropriate trades. Certain trades that would normally be permitted through a brokerage account are not permitted in a qualified plan. These include transactions that contravene the plan document, trades with parties-in-interest to the plan, margin trades, many option trades and trades that result in indicia of ownership outside the jurisdiction of the U.S. Courts. Other trades are permissible but not recommended, because they generate other operational problems. These include investments that generate Unrelated Business Taxable Income (UBTI), such as certain limited partnership interests, and purchases of assets that don't have determinable values, such as notes and real property.
- Minimum purchase requirements may prevent lower paid participants from trading their accounts with the same frequency as higher paid par-

Closed menu investment structures in bundled service arrangements present plan fiduciaries with the greatest potential exposure to fiduciary litigation.

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ticipants. With lower balances and smaller contributions, lower paid participant may be required to accumulate funds in a money market account until they meet minimum purchase requirements. This may lead to less diversification and lower rates of return for lower paid participants.

- Can plan participants make appropriate investment decisions? Often, participants are paralyzed by the sheer volume of investment possibilities available in an unrestricted investment structure, and consequently default to the money market option.

Not all providers offer unrestricted investment structures. By electing to include this structure as a plan investment options, the sponsor necessarily limits the range of service providers that may be considered.

Distinguishing Between Administrative and Investment Capabilities

Many plan fiduciaries fail to distinguish between a vendor's administrative service pricing and capabilities, and their investment management pricing and capabilities. There are various reasons for this conundrum, including:

- investment fees are generally paid directly from fund assets, through an implicit reduction in the fund's Net Asset Value (NAV). Administrative fees are generally paid by the plan sponsor, and hence receive greater scrutiny.
- investment performance and costs are difficult to evaluate, due to varying performance measurement approaches and fee schedules. Administrative services and related fees are generally easier to evaluate objectively.
- fiduciaries responsible for the vendor evaluation will work closely with the selected provider, and will rely on the provider for administrative support for functions such as distributing participant statements, processing benefit payments, etc. If administrative services are deficient, the fiduciary will receive numerous complaints and questions from disgruntled plan participants.

Although these reasons appear legitimate, ERISA makes fiduciaries responsible for ensuring that participants have the opportunity to invest in high quality funds. Investment results generally have the greatest impact on a participant's ability to retire at a suitable and sustainable standard of living. Poor investment results, coupled with poorly documented investment selection procedures, represents a plaintiff's opportunity for litigation against plan fiduciaries.

Liability Where Administration Drives Investment Decision

Closed menu investment structures in bundled service arrangements present plan fiduciaries with the greatest potential exposure to fiduciary litigation. Generally, in these arrangements the only funds available to the plan are funds managed by the investment provider that also delivers administrative services. Funds can't be selected or replaced for the plan, unless they are available through the investment provider. Although these plans tend to have relatively low "hard dollar" administrative costs, they often bear significantly higher than average investment expenses. In a September 18, 1995 article, the Wall Street Journal provided the following estimate of the relationship between administrative fees and investment expense:

> *There's a good rule of thumb for 401(k) costs: a typical bundled, one-stop shopping approach to investments and administration will, at a minimum, double the employees' cost for every 25% reduction in the plan sponsor's administration fees.*

Further, few (if any) investment providers offer solid fund options in every asset class. Thus, in selecting the integrated or bundled service provider, the plan fiduciaries may implicitly select less than optimal funds for their plan.

There are many instances where selecting integrated or bundled service providers may be prudent and defensible. For small or new plans that have limited assets, and where plan administrative expenses would be borne by plan participants, the low administrative costs of a closed menu bundled service provider

might outweigh the expected differential in investment performance between the provider's funds, and superior funds available in a more open investment structure with higher administrative costs. In this instance, fiduciaries should select the closed menu bundled service provider offering the best combination of administrative services and investment options, and should be sure to document the rationale for their provider selection decisions.

THE RFP: ASSESSING VENDOR CAPABILITIES

Once you have completed your review of administrative and investment structures, and reached some preliminary decisions regarding appropriate structures for your organization, you are ready to proceed with vendor selection. This is generally best accomplished through a formal Request for Proposal (RFP) process, where a cross section of service providers are asked to respond to a set of questions in a standardized format. The RFP permits the plan sponsor to rate the vendors in a reasonably consistent manner.

In structuring your RFP, you should ask questions that will permit you to gauge vendor's capabilities in each of the following areas:

Administrative Issues

- Adequacy of the vendor's recordkeeping and administrative systems;
- Ability to respond promptly to changing IRS/ DOL rules and regulations;
- Capability to permit your company to outsource administrative functions;
- Willingness to contain administrative expenses to a reasonable level;

Fiduciary Liability Management

- Willingness and ability to accept applicable fiduciary liability;
- Ability to comply with recently enacted Federal regulations;
- Capability to assist you to implement appropriate risk mitigation strategies;

Investment Capabilities

- Ability to provide plan participants with suitable investment choices and immediate access to their account information;
- Access to high quality funds to offer through the plan;
- Ability to provide performance information to facilitate the initial selection and ongoing monitoring of plan investment vehicles.

Participant Communications

- Quality of participant statement, and ability to customize statement at plan or participant level;
- Availability and structure of automated voice response system (VRS) and phone service representatives;
- Internet capabilities (information transmittal, account review, on-line transactions, etc.)
- Other financial planning and modeling tools that may be offered;
- Availability, cost and quality of individualized investment advice;
- Ability and willingness to conduct meetings / seminars for employees.

A System for Evaluating Responses

A successful RFP process rates vendors separately in three primary areas:

- Investment offerings, performance, diversification and fee structure;
- Service capabilities and responsiveness; and
- Administrative fees, expenses and pricing structure.

Evaluating Investment Offerings

As indicated earlier, rating investment products may be the most difficult part of the vendor evaluation process. However, in many respects, investment selection is the most important component of the vendor search. Future fund performance will determine the value of employees' retirement benefits.

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Rise of the Cross-Family Fund Alliance Structure

As previously noted, closed menu plans represent potential fiduciary liability for the plan sponsor. Consequently, closed menu plans are increasingly unpopular with plan sponsors. Margaret-Ann Cole, a principal with Kwasha Lipton, summarized the issue as fol-

This revenue sharing arrangement typically transfers between 0.25% and 0.35% of assets to the bundled provider. Recognizing that this transfer erodes the profitability of fund management, most fund companies don't offer low cost institutional class funds through alliance programs.

...be sure to evaluate the range of outside funds offered through the program. Some programs offer a limited selection of high cost funds; other programs offer a much broader range of choices. To assess the extent to which outside funds generate revenue for the vendor, ask the vendor to disclose all revenue sharing arrangements maintained with outside funds.

lows: "More and more, we're finding that no company wants to be associated with just one fund family." In response to these developments, bundled service providers are becoming more flexible in offering investments from other fund families. For example, by October of 1997, Fidelity, the leading 401(k) provider, offered 74 funds from 14 different families. Schwab offers several thousand funds from more than three hundred families. However, these fund alliances don't necessarily represent the best possible deal for the plan sponsor. Most bundled providers require that a fund participating in an alliance program share a portion of the fund's management fee, to offset the cost of providing administrative services to the plan. This revenue sharing arrangement typically transfers between 0.25% and 0.35% of assets to the bundled provider. Recognizing that this transfer erodes the profitability of fund management, most fund companies don't offer low cost institutional class funds through alliance programs.

The rise of alliance programs makes fee comparisons increasingly difficult. Most bundled providers prefer that you select most or all of your funds from their proprietary line-up, but will permit you to use outside funds, if pressed. In requesting fee quotes, ask the vendor to price services assuming that the minimum acceptable number of proprietary funds are selected. This will permit you to assess the upper range of direct costs that the vendor may assess. Also be sure to evaluate the range of outside funds offered through the program. Some programs offer a limited selection of high cost funds; other programs offer a much broader range of choices. To assess the extent to which outside funds generate revenue for the vendor (and consequently, additional costs for the plan), ask the vendor to disclose all revenue sharing arrangements maintained with outside funds.

Mutual Fund Fees

Historically, plan sponsors have paid relatively scant attention to mutual fund fees, because participants pay them through an implicit reduction in investment return. However, the DOL has made it clear that employers have a fiduciary responsibility to "Ensure that fees paid to service providers and other expenses of the plan are reasonable in light of the level and quality of the services provided." This responsibility certainly extends to mutual fund management fees, since they typically represent the largest component of a plan's operating cost (please see the companion article "Managing Your 401(k) Plan Fees" for a more complete description of this issue). Suffice it to say that mutual fund fees vary significantly, and include elements such as:

Operating Expenses

All mutual funds incur a variety of expenses including management fees, marketing and distribution costs, etc. These expenses are quantified in the fund's annual operating expense ratio(OER). In general, equity fund OER's range from less than 0.20% to over 3.00% of assets. Fixed income fund OER's generally range from less than 0.20% to over 1.50%. For no-load funds, the largest component of the fund OER is typically the investment management fee, followed by other fund administrative expenses (legal and accounting fees, fund operations, etc.)

According to the 401(k) Provider Directory (a 401(k) fee benchmarking resource, published by HR Investment Consultants of Baltimore, Maryland) total fees for a 401(k) plan with 2,000 participants and $60 million in assets average about 110 basis points (1.1%) per year. But the range of investment expenses for these plans trended between 36 and 191 basis points.

Loads and Sales Charges

Some funds may be subject to front-end sales charges. This means, for example, that $100,000 invested in a fund with a 3% sales charge is immediately worth $97,000. Most retirement plans should be exempt from front-end sales charges, so check to see whether your plan is subject to these fees. Additionally, funds may levy 12b-1 fees, generally ranging from 0.15% to 1.00% of assets. 12b-1 fees are charges assessed by the fund company to recoup marketing and distribution costs. The 12b-1 fee is part of the fund's OER. Funds with moderate to high 12b-1 fees are frequently found in alliance programs, because the 12b-1 fee is easily transformed into a revenue sharing payment.

A fund labeled as "no-load" may still have a 12b-1 fee. Funds with 12b-1 fees of 0.25% or less may legally be marketed as no-load funds. Further, several alliance programs (illegally) market funds with 12b-1 fees of up to 0.75% as "true no-load" programs.

Service Capabilities

Qualified plan service vendors have varying strengths and weaknesses. Responses to your RFP will permit you to assess each vendor's relative strengths. This is generally accomplished through a "point" system (i.e., score one to five points for each vendor's response to each RFP question). To further customize your evaluation, once you have decided which vendor capabilities are most important to your organization, you can develop a point weighting system for grading the responses, with more points allocated to questions addressing capabilities in those areas deemed most crucial for your company. For example, if local service delivery is important for your company, you could allocate additional points to providers close to your company headquarters.

Fees and Expenses

You may also want to develop a separate spreadsheet for comparing fees and expenses applicable to each possible alternative, as vendors will have different fee schedules and costing methodologies. By creating a reasonable and consistent set of assumptions for plan experience (i.e., number of participants, number of benefit payments, loan applications, interfund transfers, etc.), and applying the same assumptions to each vendor's fee schedules, you should be able to evaluate each fee schedule in a reasonably equivalent manner. Your spreadsheet should also consider ***implicit costs***, such as administrative expenses subsidized by investment management fees, and any contract or surrender charges. These costs are often significant, and in many cases may be many times greater than the aggregate explicit "hard dollar" fees.

Your spreadsheet should also consider implicit costs, such as administrative expenses subsidized by investment management fees, and any contract or surrender charges. These costs are often significant, and in many cases may be many times greater than the aggregate explicit "hard dollar" fees.

Total Plan Cost

Once you have summarized each vendor's direct fees, and implicit costs, you should also assess each vendor's total plan cost. To calculate total plan cost, you need to add fund operating expenses to direct fees and implicit costs. Fund operating expenses are calculated by multiplying the fund's OER by the total dollars allocated to (or expected to be allocated to) the fund. This calculation will require some estimation, since the sponsor can't know in advance how participants will allocate their individual accounts to the various new options offered through the plan. However, by assuming that investment allocations will remain reasonably consistent, and by assuming a rational mapping of old funds to new funds, a reasonably accurate calculation can be made.

Total plan cost is likely to be a large number, generally approximating 1% of plan assets. Additionally, the variance in total plan cost between various providers is also likely to be significant. However, the sponsor should remember that they are not required to select the lowest cost provider. Rather, the fees that the plan and participants pay must be reasonable and appropriate, given the service that the plan receives.

CONCLUSION

Selecting an appropriate investment and administrative structure for your company's qualified retirement plan is a significant, yet crucial task. The investment structure you select has a direct impact on the degree of fiduciary liability you retain. Further, your selection of investment and administrative vendors has operational, liability management and employee relations implications. Following the procedures outlined in this article provides an essential framework for:

- demonstrating procedural prudence in the selection process;
- ensuring that your investment and administrative configurations and service vendors are appropriate for your employee population; and
- avoiding the "sales claims" trap that leads to frequent turnover among plan service providers.

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There is no single formula for determining the preferred structure for a company's retirement program. Rather, final selection should be based on the sponsor's objectives and the wishes of the participant group. Indeed, multiple different investment structures may be offered within a single plan so that participants have more choice. Whatever the selected path to compliance, managing fiduciary liability management demands complete, written documentation of the decision making process and of the objective criteria used for all evaluations (both initial and ongoing) of products, vendors, and service providers.

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