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Why Fee Policy Statements?

They can help prevent fee litigation

Plan fiduciaries have recently been asking, "What steps can we take to avoid becoming an attractive target for fee litigation?" Over the past few years, Schlichter Bogard & Denton and other plaintiffs' attorneys have brought a series of cases alleging that plan fiduciaries have breached their duties of loyalty and prudence by offering investment options that carry higher fees than others available in the marketplace and by agreeing to excessive recordkeeper fees. With each successive settlement—garnering an amount ranging from roughly $6 million to $60 million—new cases have been filed and plan fiduciaries have become more alarmed. While there is no way to guarantee your plan will not be the next target, a plan sponsor can minimize the risk by not only monitoring fees and expenses on a regular basis but also bolstering documentation of the process by which fees and expenses are reviewed.

Under the Employee Retirement Income Security Act (ERISA), a plan fiduciary is charged with the responsibility to ensure plan assets will be used for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan. The decision to use plan assets to pay an expense is a fiduciary decision.

A plan fiduciary faces four critical questions when evaluating an expense:

- Is the expense properly categorized as a plan expense—i.e., an expense for administering the plan?
- If so, does the plan document permit the payment of the expense from plan assets?
- If the expense is a plan expense, is it prudent for the plan to purchase the product or service for the amount being charged—i.e., is the cost reasonable?
- If so, will paying the expense result in a nonexempt prohibited transaction?

If a plan fiduciary concludes that, yes, the expense is a plan expense, that the plan document permits it, that the expense is prudent and that paying it will not result in a nonexempt prohibited transaction, then a fiduciary can meet its fiduciary responsibilities by having the plan defray it. In answering these four questions, though, a plan fiduciary will want to know the answers to additional questions such as: How much do other service providers charge for comparable services? And: Are there similar but less expensive services that can be substituted without harming the plan and its participants and beneficiaries?

In light of the ongoing fee litigation, a plan fiduciary needs to augment those prudent decisions with documentation showing its prudent process. In other words, it is no longer sufficient to simply make prudent decisions if you can't show how you made them.

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While there are many ways to document a prudent process, one way to support and enhance the process is through the adoption of a fee policy statement. These statements can be a valuable tool to not only ensure that a prudent process is used but also to document that plan fiduciaries understand their responsibilities.

A fee policy statement can serve as evidence of prudence and also as a reminder to plan fiduciaries of the process that needs to be followed. A significant benefit of fee policy statements is that they can accomplish these purposes while still using aspirational language. It's better, for example, to use language stating that the plan fiduciaries "intend" to follow a particular method or process than language mandating or requiring the plan fiduciaries to take a particular action.

Much as investment policy statements (IPSs) gained traction over the past 20 years, fee policy statements will likely see an uptick in use over the next five or so. Because the specter of fee litigation lurks for almost every large plan, many of these are moving away from the traditional ad hoc model for evaluating plan fees. A fee policy statement can be an important piece of the paper trail that plan fiduciaries generate to show they have approved only reasonable fees and expenses.

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