

Competitive Fees: Genuine Value or Mirage of Worth

What the customer buys and considers value is never a product; it is always utility — that is — what a product does for him.

—Peter Drucker

. . . the usefulness that goes to the buyer comes not from the seller, but from the buyer's needy condition.

— St. Thomas Aquinas, *Summa Theologica*, 1265–1274

A competitive price does not necessarily mean the purchaser is getting a good value as was recently pointed out by both Supreme Court Justice Alito and Federal Appeals Court Judge Easterbrook in their decisions in *Jones v. Harris Associates*. Although their decisions involved the interpretation of §36(b) of the Investment Company Act, their conclusion impacts how 401(k) fiduciaries should interpret ERISA's duties of loyalty and prudence.

- A. How much value an employee receives from the 401(k) fees (expense ratio plus the administrative and other ancillary costs) he pays is a function of whether or not:
1. the program is getting him to engage in retirement planning;
 2. he knows (based upon the current assumptions) how much he should be contributing to get on the road to a financially secure retirement;
 3. he is using an appropriate asset allocation (and don't forget that participants interpret the inclusion of a QDIA like a target-date fund as implied advice);
 4. the performances of the actively managed investment options, when compared to the returns of the appropriate passive benchmarks, consistently justify their greater fees.
- B. How much value an employee gets out of the 401(k) plan is a function of both his desire to help himself and the fiduciaries' willingness to fulfill their duties of loyalty, prudence, and disclosure (and these are defined by constantly evolving "facts and circumstances"). When all is said and done, the fiduciaries can't force their employees to help themselves.

The fiduciaries, however, must be able to demonstrate that they are using a process that enables them to evaluate and monitor the value proposition that the 401(k) plan purportedly offers the participants. This process must:

1. apply the findings of behavioral economics and other relevant disciplines, including delivering the appropriate (targeted) messages to different employee groups that are defined on the basis of their behavior;
2. recognize the capabilities and literacy levels of the average employee (see the disturbing results of the U.S. Dept. of Education's 2003 National Assessment of Adult Literacy);

3. factor in that the average American is programmed to “spend, spend, spend” and to define his worth in terms of consumption;
4. incorporate what is now known about how most Americans approach investing/retirement planning;
5. overcome the conflicts of interests and different perspectives that exist among participants, sponsors, and providers (as frequently documented in annual studies like Wells Fargo’s *Goals and Challenges for Retirement Plan Sponsors* and Deloitte’s *Top Five Total Rewards Priorities Survey*).

C. Fiduciaries also must be able to demonstrate that they:

1. have factored in the disconnects between how participants and sponsors view 401(k) plans and retirement issues (also show in the surveys done by Deloitte and Wells Fargo);
2. did not put their employer’s goals (such as maximizing the employees’ appreciation of the 401(k) plan) ahead of the needs of the participants, including helping them to realistically assess their retirement goals and their prospects of achieving them;
3. evaluated the effectiveness of their past decisions and whether or not their providers were delivering their promised value propositions, including the purported benefits offered by professional investment management and delivered via target-date funds and/or managed accounts;
4. recognized that industry standards for benchmarking plan performance do not include assessing whether or not the employees are actually being put on the road to a financially secure retirement;
5. recognized what industry standards for benchmarking plan performance (unintentionally) really show—are we doing as poorly as everyone else?

D. Fiduciaries and sponsors also benefit when they maximize the value that participants get for the fees they pay. Fiduciaries and sponsors:

1. generate a paper trail that demonstrates they intelligently tried to fulfill their duties of loyalty, prudence, and disclosure;
2. make themselves a much less attractive target than the “guy next door” for a knowledgeable class action attorney who is looking for disgruntled and financially strapped (former) employees;
3. maximize the likelihood that many more of their employees will be able to retire in a timely fashion and thus make way for a younger and possibly more tech savvy workforce.