

**RSM! McGladrey**



**Driving out the hidden costs  
of employee benefits**

**Making benefits dollars work harder for your company and employees**

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## Introduction

When it comes to providing employee benefits, most mid-sized companies are feeling the effects of escalating costs. You need to get these expenditures in check – but cutting benefits is a risky option, and employees generally aren't interested in cost shifting.

The best tactic may be to do some detective work to undercover the true costs of employee benefits. While driving out hidden costs can be a formidable task, the gains can be considerable. In addition to saving money and avoiding serious employee retention issues, you may even identify ways to increase the value of benefits dollars.

Your company's benefits broker or trusted advisor will likely be a great resource in this process. A broker should have valuable knowledge and professional contacts in this area, and he or she may be able to ask questions and collect information to help you make informed decisions.

The following paper discusses opportunities for savings in employee benefits plans – particularly in the area of health care – and reveals possible hidden costs in company-sponsored retirement plans, along with ways to reduce them.

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## Health care consumes greatest share of benefits spending

For more than two decades, employers have relied on health maintenance organizations, preferred provider organizations and exclusive provider organizations – also referred to as health insurance “carriers” – to manage employee health care services. During this time, companies and employees have been subject to higher deductibles, higher copayments and reductions in covered services.

Employer-provided health insurance costs are expected to rise 12 percent in 2004 – the fifth straight year of double-digit increases.<sup>1</sup> For some companies, health care costs now represent as much as 25 percent of their total overhead.<sup>2</sup>

Since health insurance clearly consumes the lion's share of employee benefits spending, employers looking for savings opportunities would do well to focus on medical coverage and related areas.

## Eliminating hidden health care costs: where to start

When you receive an invoice or billing statement from a health plan, you don't necessarily see a detailed explanation of every charge. So, where should you begin your investigation? The following list, though not exhaustive, provides strategies that can help eliminate some hidden costs.

### Review your benefits plans annually

Premium levels and extent of covered care change frequently and can vary widely among carriers. But frequently pricing out your benefits plan can make carriers reluctant to give you a competitive quote.

Reviewing your benefits offering annually will help you remain in line with business objectives while establishing credibility with one carrier. Carriers are usually willing to work with companies and change their plan designs to lower costs or meet additional needs.

### **Look for alternatives to switching carriers**

Frequently changing insurance carriers can mean hidden costs in the form of new processes, re-enrollment, systems migration and administrative tasks. By implementing an automated system for your benefits administration, you can switch carriers or plans without incurring many costs associated with integration.

Rather than switching carriers, you may also be able to work with your current carrier to make the plan design more cost effective. This may involve changing the type of plan or benefits, offering voluntary products or taking advantage of pre-tax savings. Also keep in mind that higher employee participation equals lower premiums, so ask your carrier to provide education about the benefits of enrollment.

### **Explore a cafeteria plan**

Employees can realize significant savings through the use of Section 125 plans – also known as “cafeteria plans.” These plans offer employees a variety of insurance options and are often combined with a flexible spending account that uses pre-tax dollars to pay for unreimbursed medical and dependent care expenses. Employees can customize their benefits while reducing taxes and increasing take-home pay. Employers also save money through reduced FICA taxes and lower overall benefits costs.

As is the case with other plans, greater employee participation leads to greater savings for the company. But employees may be uncomfortable with enrolling in a flexible spending account because of the “use it or lose it” element of the program. To address these concerns, your carrier should provide information about plans available through flexible spending accounts and offer confidential consultation to help employees determine the best option and projected impact on their take-home pay.

### **Use technology to save time and money**

Conducting administrative tasks through traditional methods, such as telephone and fax, can be inefficient and wasteful compared to online technologies. Much

of this waste can be eliminated with an online benefits administration management system that allows human resources administrators to input data, generate reports and conduct other related activities. This has proven to be an effective cost-reduction measure for many companies because, among other advantages, it enables them to scale back human resources personnel. North American companies that implemented Web-based benefits administration tools reported an average cost reduction of 43 percent and a return on investment of less than one year.<sup>3</sup>

With Web-based tools, employees can also go online to view personal information or request changes. Depending on the type and size of the plan, for example, it can take 15 minutes to complete online enrollment – a process that once buried companies in paperwork for days.

Implementing a benefits administration system that is integrated with other human resource functions reduces costs even further. Benefits administration and payroll systems that “talk” to each other – meaning updates in one system are reflected in the other – eliminate the need for redundant data entry and increase data accuracy.

### **Outsource human resources functions**

Human resources personnel who manage employee benefits can be overwhelmed by a multitude of complex and time-consuming tasks. Outsourcing benefits administration can save processing time, effort and expense.

Companies that contract with a human resources services firm to automate certain functions can reduce costs by 25 to 30 percent.<sup>4</sup> Benefits invoice reconciliation, for example, can be completed with the click of a button.

Many human resources and benefits administrators are knowledgeable about plans but do not know how to effectively broker on behalf of the company. This can lead to overpayment for benefits. Outsourcing frees up human resources staff for other valuable, productive tasks that leverage their skills.

### **Use an integrated, single-source solution**

Companies that work with multiple carriers to provide employee health and welfare insurance products must generally contend with a range of complex systems, processes, forms and premium payments.

A multiple-carrier arrangement requires a significant amount of time to administer and can be costly in terms of personnel. Companies may also find their limited technological resources overburdened in an attempt to coordinate with the different carrier systems. And all employees spend more time and effort trying to learn about different plans and providers.

Companies may want to consider an integrated benefits solution. Working with a single source for benefits brokerage and administration, payroll and billing services can greatly simplify and streamline benefits management. A single-source solution can conserve information technology resources and eliminate the stress of maintenance, updates and hosting. It can also lower costs without commoditizing the products.

A knowledgeable, customer-oriented broker can help you design an optimal benefits package and negotiate to ensure you get the right products at the best possible prices.

Using a single broker who can negotiate benefits on your behalf with all your carriers can help you leverage economies of scale and get similar benefits plans at lower costs – or at least reduce the impact of escalating premiums.

A single broker who provides one-on-one, multiple-site or multiple-product enrollments can dramatically reduce your costs during annual open enrollments.

### **Encourage healthy lifestyles and personal responsibility**

Employers can create financial and other incentives for employees to take better care of themselves, such as sponsoring or paying for fitness classes and smoking cessation programs. They can also encourage employees

to better manage their personal health care program through higher deductibles and copayments.

Educating employees to make prudent decisions about when they should see a physician will lead to lower premiums. And companies that establish a corporate wellness program save money because employees tend to be healthier and require fewer medical services.<sup>5</sup>

### **Analyze post-retirement medical benefits**

Until 1993 most employers accounted for retiree health care costs on a pay-as-you-go basis. Beginning that year, however, accounting standards required employers to expense such post-retirement medical benefits in advance, thus reducing corporate earnings and multiplying the pay-as-you-go cost by several times.

Although many companies are reluctant to reduce retiree health benefits, continuing the same financial commitment to retirees can be burdensome. Employers must reevaluate their level of commitment to these benefits and consider pre-funding to meet future obligations.

### **Examine trade-offs of reducing benefits**

The squeeze on the benefits dollar is real, but employers should consider the following possible repercussions of making dramatic changes.

- *Loss of good employees.* Maintaining a competitive, cost-effective health plan is critical to attracting and retaining key executives and a quality workforce. Increased turnover due to inadequate benefits can also be costly to employers.
- *Employee dissatisfaction.* Reducing health insurance coverage may seem necessary these days, but it can have a negative effect on the workforce – and not just in the form of resentment related to paying higher premiums.

A recent study by MetLife shows that less than one-third of employees are satisfied with their current benefits program, a 9 percent drop from a year ago.

The study also shows that a major factor in the dissatisfaction is a lack of communication between employer and employees about the types of benefits that are available. Frequent changes in carriers or lack of understanding about benefits options create frustration and contribute to decreased morale.

- *Too much red tape.* When benefits coverage is reduced, employees may end up using company time to straighten out payment issues and make inquiries. Decreased productivity and other indirect costs of reducing benefits should be factored into any decision.

### **Simplify benefits activities**

When one company merges with or acquires another, it can mean big changes in employee benefits and retirement plans. The new entity is unlikely to carry two separate plan structures with redundant costs. One of the company plans may also have underlying liabilities or costs that the other company is unwilling to assume. Combining the plans, while protecting the interests and employees of both parties, can be a complex process requiring outside expertise.

Executing the many associated benefits brokerage and administration tasks can also consume significant time and money. Benefits invoice reconciliation, for example, can take days for the human resources administrator to complete.

Implementing an automated system can make reconciliation easy – and when other systems are integrated, tasks can be completed with greater accuracy and without redundant data entry.

With an integrated automated benefits management system, a mid-sized company can complete government-required census reports and generate

demographic details in minutes, rather than the weeks such tasks would typically require. For example, BBB Service Company, Inc., which operates Wendy's restaurants across the country, elected to remain with the same insurance provider, but completely revamped its health care plan. By doing so, the company was able to offset the rise in premiums and reduce deductibles and copayments by 10 percent.

### **Retirement plan costs: don't ignore expenses you can't see**

There has been increased attention recently on fees and hidden costs associated with retirement plans. Excessive plan expenses can siphon thousands of dollars each year from a mid-sized company's retirement plan.

During the late 1990s, when stock market returns exceeded 20 percent annually<sup>6</sup> and money poured into 401(k)s, investment expenses embedded in a typical plan were easy to ignore. This changed in response to reduced returns in subsequent years, and plan sponsors and employees began to scrutinize expenses more closely. Now, with benefits costs exploding, watchful executives and benefits managers are closely monitoring retirement plans to make sure they get every dollar of value from them.

Plan sponsors are also increasingly aware of their fiduciary responsibilities under the Employee Retirement Income Security Act (ERISA). This law requires that sponsors discharge their duties solely in the interest of plan participants. ERISA does not specify acceptable levels of plan fees, but it directs fiduciaries to agree to fees that are "reasonable."

High-profile corporate governance scandals in recent years have also caused regulators to pay greater attention to retirement plan fees. The U.S. Department of Labor is more closely analyzing – and in some cases,

auditing – how employers manage fees and expenses. Recent mutual fund misconduct involving late trading and market timing have also influenced companies to drop tainted funds from their 401(k) lists. In fact, 60 percent of companies that recently modified their plans cited legal or fiduciary concerns as a main reason.<sup>7</sup>

### **Impact of fees on employees**

Plan participants share a considerable portion of retirement plan expenses. In fact, nearly all investment management fees are paid out of employees' plan assets. Because high fees have a negative impact on long-term fund performance, employers should carefully monitor fund selection.

The following example from the U.S. Department of Labor describes the impact of fees:

*You are an employee with 35 years until retirement and a current 401(k) account balance of \$25,000.*

*If returns on investments in your account over the next 35 years average 7 percent, and fees and expenses reduce your average returns by 0.5 percent, your account will grow to \$227,000 at retirement, even if there are no further contributions to your account.*

*If fees and expenses are 1.5 percent, however, your account balance will grow to only \$163,000. The 1 percent difference in fees and expenses will reduce your account balance at retirement by 28 percent.*

Low-expense funds frequently outperform similarly managed funds with high expenses, so this is one obvious strategy for controlling plan investment costs. But monitoring and analyzing the actual costs of a company retirement plan can be difficult.

Many investment and administrative fees are not easily found on a fund performance report or even in a prospectus. As a result, as many as 75 percent of employers do not know the total costs of their retirement

plan.<sup>8</sup> By one estimate, the difference in fees between the least expensive and most expensive plans can be as much as 300 percent.<sup>9</sup>

### **Retirement plan fees are generally hidden in three key areas:**

- Investment management fees
- Administrative fees
- Trustee fees

### **Investment management fees**

Investment expenses typically constitute 70 percent or more of total plan costs.<sup>10</sup> Because they are usually calculated as a percentage of the total plan assets, the dollar amount of the fees can grow significantly over time through the addition of new employees, increased contributions from existing employees and positive investment performance.

An easily uncovered investment expense is the mutual fund expense ratio, which can range from less than 0.5 percent to as much as 2 percent of assets.<sup>11</sup> This ratio is usually found in the fund prospectus. While plan sponsors can't control this expense for an individual fund, they can look for funds with low expense ratios.

Many investors assume that higher expenses in some way pay for superior investment performance. In fact, much investment research – by Morningstar, Standard & Poor's, and others – has found that below-average expenses are correlated with higher-than-average performance. Diligent plan sponsors and investment fiduciaries will pay attention to such research when selecting funds for a company retirement plan.

Other investment expenses are usually devoted to revenue sharing for service and marketing. These may include 12b-1 fees, that is, distribution payments that are usually 0.25 percent of assets and disclosed in the prospectus, finder's fees, dealer commissions and shareholder serving

reimbursements (sub-transfer agent arrangements). Such fees are often not stated in prospectuses or plan documents, and companies may have to request their disclosure.

It is possible to capture certain revenue-sharing fees and return them back to the plan. Ask the provider about negotiating such items. Depending on the size of the plan, the average account balance and other factors, a plan provider may be receptive to fee renegotiations. At the very least, your plan provider should be willing and able to quantify the revenue sharing they are receiving from your plan assets.

### **Administrative fees**

Administrative fees consume a smaller portion of total plan costs, usually 10 to 20 percent.<sup>12</sup> Generally, administrative fees will run between \$100 and \$200 per participant per year.<sup>13</sup>

Plan administration fees can be charged as a percentage of total plan assets or as a fixed amount per participant. Or they can be charged to individual participants for the execution of specific tasks, such as making a loan or executing investment directions. Many plans use a combination of these fee structures.

Other “soft” internal administration costs can include managing and recording payroll information, holding employee enrollment and investment education meetings, and handling a high volume of forms related to enrollment, investment election changes, deferral changes and quarterly financial statements.

### **Trustee fees**

Fees paid for trustee services account for a relatively small part of total plan costs, perhaps 5 to 10 percent.<sup>14</sup> The challenge of assessing whether trustee fees are reasonable, however, can be big. A number of factors impact pricing, including services provided, investments offered, transaction processing needs and fee schedules for proprietary investments.

In general, trustees charge either a flat fee ranging from \$500 to \$2,000 for a limited number of investment options, or a minimal annual fee ranging from \$1,500 to \$3,000, plus a percentage of the trust assets, for a larger number of investment options. Depending on the size of the trust assets, the percentage can range from 0.06 to 0.15 percent for subsidized trust companies or from 0.10 to 0.50 percent for unsubsidized trust companies.<sup>15</sup>

### **Identifying hidden costs in your company retirement plan**

Many plan sponsors don't understand or account for the various fees they pay to vendors. They may even think that certain services are free because the cost of those services isn't explicitly stated. Of course, that's unlikely.

Identifying costs that aren't readily apparent isn't a simple task. Some vendors use a variety of complex mechanisms to structure their fees: some services are “bundled,” while others are separate items.

Uncovering all of the costs can be like peeling an onion, so consider the following suggestions.

- Unbundle providers' services in order to make comparisons.
- Examine plan proposals and documents, vendor fee schedules and billing statements. Do some calculations.
- If plan providers don't disclose, or at least offer, an estimate of retirement plan fees, insist on more information.

The more you know, the better you'll be able to monitor your plan and negotiate the best deal for your company.

### **Use a cost analysis to find savings opportunities**

A cost analysis of a company's 401(k) or other defined contribution plan can identify opportunities for cost reduction and enhanced services. And comparing plans can reveal significant differences in service levels, timeliness, accuracy and compliance.

To begin a cost analysis, develop a worksheet of costs related to plan components – administration fees, trustee fees and investment fees. Figuring costs this way allows you to compare competing plans to benchmark relative costs.

A uniform 401(k) fee-disclosure worksheet developed by the American Bankers Association, American Council of Life Insurance and Investment Company Institute is available from the U.S. Department of Labor at [www.dol.gov/ebsa/pdf/401kfefm.pdf](http://www.dol.gov/ebsa/pdf/401kfefm.pdf). This worksheet allows you to record fund expenses and provider fees.

You may need to ask your plan vendor to provide much of the worksheet data, but some expenses can be found in plan documents and fund prospectuses. This information will provide a basis by which to compare providers and to make sound decisions.

With the information you collect, build a benchmark for your company's plan, or work with a consultant who can assist you with this process.

Once you have established a benchmark for comparing your company's plan against similar plans, update it every one or two years. Relative plan costs will change over time as plan assets grow and the employee population expands – especially if fees are asset-based.

Benchmarking will allow you to quantify total plan costs, monitor changes over time and provide cost information to employees and regulators.

### Get a handle on hidden costs

A few final ideas to help you get retirement and health care plan costs under control:

- Periodically calculate and keep a record of total plan costs. This will help your company fulfill its fiduciary responsibility and demonstrate that it has done so.
- Anticipate future costs by analyzing trends and projecting asset and participant growth.

- Make sure oversight committees and benefits managers agree on plan cost-control objectives and communicate regularly about their status.
- Identify and compare services and costs using a relevant benchmark.
- If you identify excessive fees or inadequate service in your plan, work with your provider to negotiate fees or enhance services.
- When considering switching providers, understand the work and disruption this may entail.
- If you do switch providers, you may want to work with a consultant or broker who can ensure you get the best long-term value for your company and employee. The right broker will ensure you understand your options and offer guidance, so you can feel confident in your decision.
- Work with a trusted advisor or consultant to identify concerns, conduct a plan analysis and implement recommended solutions.

### How RSM McGladrey can help

As you begin to apply the suggestions in this report, you may encounter more difficulties than you expected in uncovering the costs of your employee benefits programs. RSM McGladrey can make the job a little easier.

Our health care and retirement plan benefits consultants will work with you to make sure that your benefits programs are designed to meet business objectives and to leverage every benefits dollar you spend.

RSM McGladrey Employer Services provides integrated payroll processing, payroll tax filing, human resources data management, benefits brokerage, enrollments, benefits administration and Web-based self-service technology – all through SingleSourceTechnology<sup>SM</sup>, the leading vendor solutions system. RSM McGladrey Employer Services also acts as a full-service benefits brokerage agency and administers Fortune 500-type core and voluntary benefits for mid-sized companies.

RSM McGladrey Retirement Resources provides retirement plan solutions for mid-sized companies. Its highly specialized and experienced team offers plan design, administration, consulting and investment advisory services to qualified and nonqualified retirement plans including 401(k) plans, money purchase plans, defined benefit plans, cross-tested profit sharing plans, employee stock ownership plans and many other types of plans.

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Norbert "Norb" Feltrop has 16 years of experience in the area of employer benefits. He currently oversees plan design, benchmarking, insurance quoting and negotiation, assessment analysis, strategic planning and quarterly claims utilization review and analysis for clients across the Southeastern United States. Before joining RSM McGladrey Employer Services, Feltrop managed sales and accounts for mid-sized companies. Feltrop graduated from McKendree College in Lebanon, Illinois, with a Bachelor of Arts degree in business administration and sociology and earned his Master of Business Administration from Webster University in St. Louis, Missouri.

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Martha Sadler has more than 15 years of experience in the employee benefit plan area. Her consulting experience includes ensuring benefit plans meet employer objectives and are in compliance with governmental regulations.

Sadler assists employers with correcting plan problems and representing employers with the Department of Labor and Internal Revenue Service in connection with plan audits. She also prepares requests for advisory opinions from the Department of Labor and for private letter rulings from the Internal Revenue Service. Sadler has earned the designations of a certified pension consultant and qualified pension administrator from the American Society of Pension Actuaries.

### **About RSM McGladrey**

RSM McGladrey Business Services, a wholly owned subsidiary of H&R Block (NYSE: HRB), offers a broad range of business services to mid-sized companies, including business and tax consulting, wealth management, retirement resources, employer services, corporate finance and financial process outsourcing. Companies in the business services segment include RSM McGladrey, Inc., RSM McGladrey Business Solutions, Inc., RSM McGladrey Employer Services, RSM Equico, Inc., and RSM McGladrey Financial Process Outsourcing, LLC.

RSM McGladrey, Inc., is a leading provider of tax and business consulting. McGladrey & Pullen, LLP (a CPA firm owned by its individual partners) provides assurance services. RSM McGladrey and McGladrey & Pullen have an alternative practice structure. Though separate and independent legal entities, RSM McGladrey and McGladrey & Pullen work together to serve clients' business needs. They are members of RSM International, the sixth largest worldwide association of consulting and CPA firms (source: International Accounting Bulletin). RSM McGladrey offers specialized products and services to the RSM McGladrey Network, a group of 85 independent accounting firms in the United States and Puerto Rico.

RSM McGladrey Retirement Resources comprises RSM McGladrey Business Solutions, Inc., RSM McGladrey, Inc. and Birchtree Financial Services, Inc. Participant accounting, administrative and consulting services are provided by RSM McGladrey Business Solutions, Inc. Investment

advisory services are provided by RSM McGladrey, Inc., an SEC-registered investment advisor. Insurance products and certain securities are made available through Birchtree Financial Services, Inc., member NASD.

RSM McGladrey Employer Services is a full-service brokerage agency offering benefits brokerage, benefits administration and payroll processing.

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