401(k) Investments

Benchmarking: What Is It Good For?

Institutions will try to preserve the problem to which they are the solution.
—Clay Shirky, NYU Professor

I find that I tend to get the right answer if I have the right question.
—Rich Budke, Entrepreneur-Turned-401(k) Advisor

Benchmarking is a powerful tool that plan sponsors and their advisors need and should want, but not necessarily for the reasons or in the form most accept as "prudent." There is nothing inherently wrong with mountains of data printed on slain forests (except for the slain forests part); it's just that there's also nothing inherently right about these reports. To get the right answer, we need to start with the right question; and to understand the role of benchmarking, we should ask what problems we hope it will solve.

By Pete Swisher

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Prudence ≠ Paper: The Myths of Data and Documentation

Defense attorneys like to paraphrase the "location, location, location" of realtors as "documentation, documentation, documentation." This makes sense if the question is, "What should plan sponsors do to maximize their odds of winning lawsuits?" The answer then is detailed processes and exhaustive documentation to be trotted out as conclusive evidence of prudence in a hypothetical court case.

I have two problems with this:

1. It's the wrong question.
2. Something will always be missing.

"How Do I Win Lawsuits?" Is the Wrong Question

There are roughly 6 million employers in the United States, and only about 15 percent of them have retirement plans. Most of those with plans are small employers—under 100 eligible employees. And lawsuits are not the biggest worry of the majority of these employers. Most employers simply want to know how to save time, save money, and help their people. Why, therefore, do we in the retirement industry expend so much energy on solving the lawsuit-winning problem when this is relatively low on the list of what matters? The answer, to a degree, is in the quote above: "Institutions will try to preserve the problem to which they are the solution." Advisors want to be meaningful, so they have crafted a sales pitch that says, in essence, "You are at risk and need me in order to run and document this very complicated process."

The problem is that what the employer wants is mostly about time, money, and people, and only partly about lawsuits.

Something Will Always Be Missing

Documentation is, at best, a two-edged sword. Consider a simple universe in which prudence has only three "to do" items. Now imagine a retirement plan committee in this universe exhaustively documenting processes surrounding two of those three items, but not mentioning the third at all. In such a universe, the failure to mention item three—amidst the detailed documentation of items one and two—might be seen as damning evidence of imprudence. The point: if you take the path of "documentation,

documentation, documentation," you had better document everything and forget nothing. And in a world in which the "to do" list has scores if not hundreds of items—not just three—overlooking something is almost guaranteed. Be realistic. If you have 50 clients, can you honestly say that the minutes of meetings for all 50 will show prudence on EVERY issue of importance to fiduciaries, EVERY time? And if the answer is what it obviously must be—that, of course, you and your human clients will fail to get it right 100 percent of the time—could it be that you have done a disservice to those clients by insisting on a heavy burden of documentation?

Strength of Benchmarking Is Its Ability to Reduce the Documentation Burden

So what points am I making about benchmarking? Probably not what you think. First, the fact that exhaustive documentation of prudent process will virtually never be complete enough actually supports the value of benchmarking. Instead of encouraging clients to write everything down, how about just keeping a copy of a benchmarking report and having the minutes reflect that the committee reviewed and discussed the report?

Second, more is not necessarily better. This is worth restating: more documentation is NOT better, because every client will fail to document what it should some of the time. We should, therefore, be very careful in what we encourage our clients to document. Remember: the requirement is not that we *document* a prudent process; the requirement is that we *follow* a prudent process. An excellent process that is heavily but incompletely documented might appear to a court to be imprudent due to the missing elements. Yet, that same process with little or no documentation allows an employer to articulate in court what the process consists of—accurately, verbally—without having to fend off the plaintiff's lawyer's dissection of your written records. This does not mean written processes and documentation are a bad idea, only that one must be careful about what gets documented and what does not.

In the struggle to protect employers from fiduciary liability, benchmarking is a powerful tool for demonstrating prudence without exhaustive, additional documentation.

Where Benchmarking Works Best

Benchmarking—in the form of RFPs, RFIs, or benchmarking reports—is perfect for:

- Comparing fees;
- Comparing services being provided at various fee levels;
- Comparing participant metrics such as participation and savings rates;
- Conducting periodic due diligence in lieu of a full RFP—the greatest life-sucking time-killer in the history of mankind; and
- Comparing any aspect of a plan that has reached the third stage of innovation—widespread adoption and systematization.

Using benchmarking for these purposes can be as simple as reviewing the highlights of a report and having the committee minutes reflect that this occurred.

Quis Custodiet Ipsos Custodes?

This famous Latin quote is one all fiduciaries should know—it means, roughly, "Who will guard the guards themselves?"

Who will benchmark the benchmarkers? It is with some humor—and understanding—that I point out what should be obvious: advisors are not benchmarking themselves. But more importantly, they are not necessarily telling their clients that the advisor must be benchmarked. If prudence requires a 20-page benchmarking report about the recordkeeper, where is the 20-page report about the advisor? The auditor? The TPA?

Where Benchmarking Is Blind

Benchmarking is inherently blind to innovation and even possibly a deterrent to it. Innovation emerges in stages. First is the idea: someone has to have the idea and bring it to market. Second is the "heuristic" stage: a few key people in the business have mental models and values about how to deliver the innovation, but there simply has not been enough time to systematize its delivery. Effectiveness relies on those who know the most to make it happen. The final stage is systematization: the idea becomes mainstream and is reduced to processes and checklists and becomes commoditized.

The fundamental problem with benchmarking is that it is, by nature, limited to stage three. Only when an innovation is no longer an innovation—in fact, only when it is so entrenched as to be nearly ubiquitous, thereby enabling the existence and collection of comparative data—can it be benchmarked. *Innovations, by their very nature, cannot be benchmarked*. In a world where no vendor is hired unless it can prove, through

benchmarking, that it is better and cheaper, innovation is all but impossible.

Consider, for example, the emerging world of 3(16) administrative outsourcing. In my testimony to the ERISA Advisory Council in 2014 (posted on the Department of Labor Web site) I describe multiple flavors or models for such services. Which model is best? What does each model actually consist of? And how do you choose a provider when most of them just hung out the proverbial shingle last week? The answer is that you simply cannot benchmark a new service like this, but the absence of comparative data is by no means a deterrent to embracing the innovation. Lack of comparative data is actually a hallmark of creative thinking—after all, only *old* ideas are backed up by experience data.

Another example is plan investments. The volume of data available on mutual funds and other investments is nothing short of staggering. On balance, this is helpful to fiduciaries, but it has the side effect of making it extraordinarily difficult to deviate from the perceived middle-of-the-road. To a degree, benchmarking has squelched investment innovation in the retirement plan space.

Conclusion—Put Progress Before Data

A distracting vibe has arisen in the pension business. Advisors who catch this vibe buy into the notion that the job is defined by endless data, documentation, and process minutiae. RFPs, RFIs, and benchmarking reports—because they are chock-full of minutiae—can distract us from things that are actually meaningful. When the time allotted to a given topic in a retirement plan committee is determined, in part, by the length of a particular report, the longest report ends up getting the most attention. Is this really what we should be doing?

All of us in the value chain of the private retirement system, including vendors, advisors, and plan sponsors, should use benchmarking. It makes life simpler. But if our collective viewpoint requires us to limit client choices to the benchmarkable, we might as well fold up our tents and hand over the job of running the retirement system to government, because stifling innovation through bureaucracy and the safety of data is a perfect role for government. If, instead, we believe in a private retirement system, we should focus on delivering on the promise of private enterprise—innovation and results. ■