

SilverStone Group

EMPLOYEE BENEFITS

Investment Services

Apples to Apples

A Fruitful Way to Shop for Your Retirement Plan

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Generally speaking, when consumers make purchases they like to know *what* their money is going towards. Furthermore, they appreciate the assurance that comes from knowing they will receive a quality product for their hard-earned cash. The retirement planning industry is not immune to this need and is currently undergoing regulatory renovations to meet this standard. Legislation to ensure plan sponsors receive sufficient information regarding the fees charged by service providers was first introduced by the Department of Labor (DOL) in December of 2007 and became “interim” regulation on July 16, 2010. The goal of the new legislation is to provide better transparency of fees in bundled arrangements and revenue sharing.

As of the effective date, which is set for January 12, 2012, service providers will be required to provide comprehensive fee disclosure to all plan fiduciaries on both existing contracts, as well as new service arrangements. The objective is to give plan sponsors the opportunity to evaluate services and fees using a true “apples to apples” comparison. However, a troublesome question lingers: is it really going to be that easy to compare?

And the total comes to...

In order to compare fees side-by-side, it is essential to understand the types of fees a plan can have. Typically, a plan is going to have 2 sets of fees: *plan administration fees* and *investment related fees*.

Plan administration fees: These are fees that generally encompass services such as recordkeeping, trustee, custodial, legal and investment management. While it is possible to negotiate each of these services independently, most plans use a bundled arrangement that wraps all or most expenses into one package. They then charge a single fee, usually referred to as the “recordkeeping” fee. Factors that determine the fee amounts include the size of the plan, number of participants and average account balance. These fees tend to be easily identified and, thus, provide a better way to compare vendors. Oftentimes they are negotiable, especially in a competitive environment or when a plan goes out to bid.

Investment related fees: These fees come in several different forms, such as an investment management fee, a 12b-1 fee, a sub-TA fee, shareholder servicing fees and transaction fees. They are calculated as a percentage of assets in a particular investment; therefore, the more money in the fund, the more revenue for the plan provider.

The plan providers use these fees to help offset the costs associated with plan administration. They are usually negotiated by the recordkeeper for the right to offer an investment on their platform through what is known as “revenue sharing.” It is through these revenue sharing arrangements that certain plan providers can market their services to plan sponsors as being “free.”

Until recently, plan administrators have not been required to disclose such charges. It is these specific fees that are clouding the ability of plan sponsors and participants to get a fair understanding of what the true costs of the plan are, and they are a driving force behind the new legislation promulgating greater fee transparency. As a plan sponsor, it is your duty to understand how various fee arrangements work and what the true costs are to your participants for the funds in which they are investing.

Additional charges may apply

Another cost a plan may incur is an *investment advisor fee*. Many plans use the services of an independent investment consultant to help guide them through the process of offering a plan. Consultants are often paid a percentage of plan assets for their services. Under 408(b)(2), advisors are going to be required to be upfront about how they are getting paid. There are currently several ways an advisor can receive compensation through the plan. The most common are:

An upfront commission – In this scenario, the advisor receives a one-time payment of 0.50 - 1.0% of the plan assets at the time the plan moves from one provider to another. After the upfront payment, the advisor then receives trail revenue totaling up to 0.25% of plan assets. The costs of paying out the large, upfront commission are spread out over the life of the plan and are underwritten by the participants.

A flat fee – The most frequently used payment option is calculated by a flat percentage of the assets in the plan. This fee can range from 1.0% on plans under \$1 million to 0.10% or less on larger plans. Fees typically range between 0.25 - 0.50%, depending on the size of the plan, and they are paid out by the assets in the plan.

A hard dollar fee – This form of payment is growing in popularity. Essentially, it is a fee agreed upon at the initiation of the relationship between the plan sponsor and the investment advisor. The fee is charged on a quarterly basis and is paid directly by the plan sponsor. This sort of arrangement is most common among plans over \$100

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million, but it is starting to be utilized for smaller plans. The advantage of this payment method is that it reduces the expense of the plan to the participants, resulting in slightly better returns. The downside, however, is the hard dollar cost to the employer offering the plan.

With the increased focus on fee disclosure, it is likely the upfront commission structure is going to become less accepted because of the large, initial payment required to make a switch from one provider to another.

The good, the bad

Overall, full fee disclosure is a positive change for the retirement plan landscape. It is going to equip plan sponsors with the ability to better compare plan administrators and service providers on an equal playing field. It will also drive out the rouge companies that have been unfairly profiting off of plan participants and create a more competitive and efficient marketplace for consumers.

The potential downside associated with increased regulations on fee disclosure is that it may create too much information for plan participants to absorb. Beginning in 2012, the fees previously discussed will be provided to all participants, most likely through their quarterly statements. This means that plan sponsors will need to be well-educated in order to field consumer questions. The biggest concern is that uneducated participants with small account balances will receive their quarterly statement and experience “sticker shock” from the fees associated with their plan. For example, if a participant invests roughly \$1,000 and receives a quarterly statement that shows it is costing them \$200 a year in total fees to be in the plan, they may decide that the plan is too expensive and cease contributions. Plan sponsors will face greater accountability to educate participants in order to avoid an exodus from the plan.

Preparing plan sponsors

Plan sponsors need to prepare themselves for the influx of new fee information. Conducting a benchmarking study is an effective way to gain a true understanding of plan particulars. Fortunately, the resources available to conduct this level of analysis are readily available. A great tool that is easily

accessible is BrightScope (www.brightscope.com). This is a free website that uses the information available on your 5500 to rank your plan against your peers’ plans based on a variety of information such as plan fees, investment quality, company generosity or the likelihood of an employee enjoying a successful retirement.

If a benchmarking study proves that the fees associated with a plan are out-of-line relative to others, there are several steps to be taken:

1. Plan sponsors should first try to renegotiate with the current plan administrator. Many plan providers will be willing to reduce their fees in an attempt to retain business. It is not uncommon for providers to be less than proactive about reducing their fees, especially if a plan has grown significantly in a relatively short period of time.
2. The next step for plan sponsors is to review the mutual funds share class. Many plans are still using high expense retail funds in the plan line-up. These funds are loaded with revenue sharing that is not always being passed down to the participants. Looking for a similar fund with an institutional or retirement plan share class (also called an R share) could be advantageous for a number of reasons, such as the requirement for plan administrators to disclose their fees for recordkeeping and administration. If you are not able to replace a fund with an institutional or retirement share class, ask your advisor or the administrator to disclose how additional revenue from the higher fees is being used. The outcome should ultimately benefit the participant in the plan.

Shoppin’ around

With all the focus on fees, it is crucial not to lose sight of the plan value. As in many situations, the cheapest option is not always best. It is important you are getting what you are paying for. Whether you are selecting administration, investment management or advisory services, it is not always wise to select the least expensive option. It is more important to confirm the value of the plan you paying for.

Though the new regulations set forth by 408(b)(2) do not come without challenges, the increased emphasis on fee transparency should be a significant benefit for plan sponsors and participants. Employees are going to have more information available to them and, thus, will likely ask more questions. Plan sponsors will have an increased responsibility to effectively communicate with participants, but these changes will ultimately create an opportunity for consumers to fully understand the fees associated with the plans that best fits their unique needs.