



**SPECTRUM**

PENSION CONSULTANTS

# Understanding Retirement Plan Fees

Virginia L. Gibson  
Attorney

Kevin E. Boercker  
Senior Consultant

# How are 401(k) Fees Like Icebergs?





Why Should You Care?

Fee Basics

Case Studies

Summary and Questions



---

Why Should You Care?

Fee Basics

Case Studies

Summary and Questions

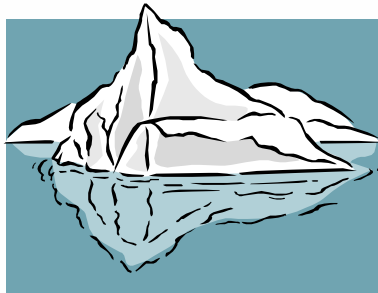


# Why Should You Care?



## What's In It For You:

1. The law, DOL, and courts require you to “care”
2. New written disclosure rules are coming...
3. Fees can have a significant economic impact





## The Law Says:

*“A fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and **defraying reasonable expenses of administering the plan.**”*

-ERISA Section 404(a)(1)





## The Department of Labor Says:

*“ . . . Plan fiduciaries must assure that the compensation paid directly or indirectly by the plan to [the service provider] is reasonable, taking into account the services provided to the plan as well as any other fees or compensation received by [the provider] ”*

*“The responsible plan fiduciaries, therefore, must obtain sufficient information . . . to make an informed decision whether [the provider’s] compensation for services is no more than reasonable.”*

-Advisory Opinion 97-15A (The Frost Opinion)





## Class Action Law Suits:

Sponsors breached fiduciary duty and/or engaged in prohibited transactions by ...

1. Failing to monitor fees and allowing plan to pay unreasonable fees

2. Failing to understand how 401(k) vendors collect payment of their fees





## Congress' Fee Disclosure, Likely to See:

1. Required disclosures on participant statements
2. Required disclosures to plan sponsors
3. Must provide investment info to participants
4. Rules addressing “conflicted” advice issues
5. Mandated investment options (?)

Analogy...



# Why Should You Care?



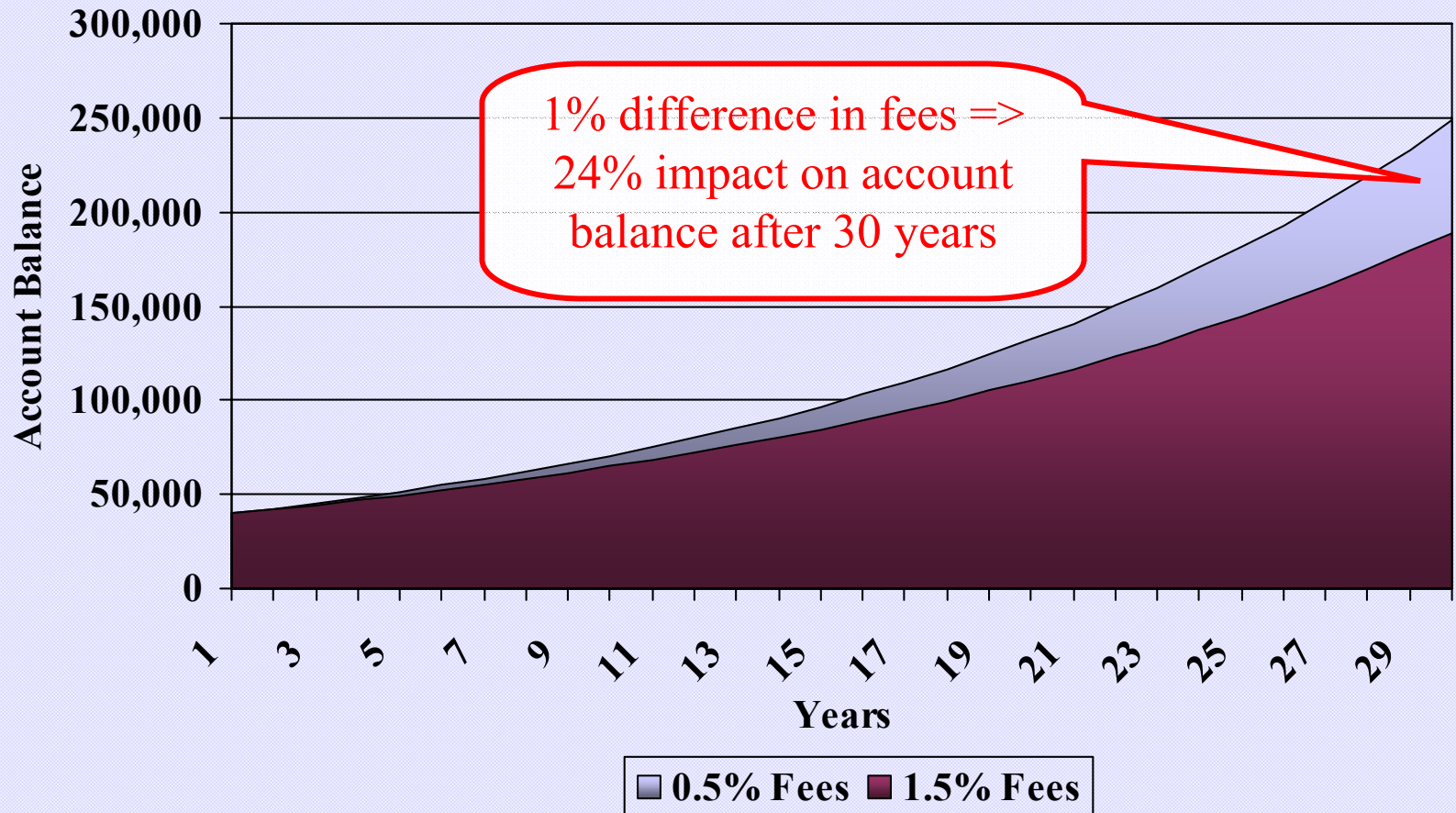
## Congress' Fee Disclosure, Likely to See:



# Why Should You Care?



## Fee Impact Illustration





## Sidebar: Plan Sponsor “Settlor” Activities

1. Activities related to formation, design, or termination of a retirement plan
2. DOL position: Settlor activities not fiduciary activities, not plan expenses
3. Only “reasonable” plan expenses may be paid out of plan assets

**Conclusion: Fees for “settlor” activities cannot be paid from plan assets**



# Why Should You Care?



Plan Can Not Pay (settlor)	Plan May Pay (non-settlor)	Plan Must Pay (investment)
<ul style="list-style-type: none"><li>• Plan Design Study</li><li>• Initial Drafting of Plan Document</li><li>• Discretionary Amendment / Restatement</li><li>• Employer financial impact study</li><li>• Union negotiations relating to plan</li></ul>	<ul style="list-style-type: none"><li>• Necessary administration</li><li>• Communication of plan info to participants</li><li>• Required amendments / restatements</li><li>• Obtaining IRS determination letters</li><li>• Investment Advice</li><li>• Trustee Fees</li></ul>	<ul style="list-style-type: none"><li>• Brokerage Commissions</li><li>• Surrender Charges</li><li>• Expenses “intrinsic to the value of the assets”</li></ul>





---

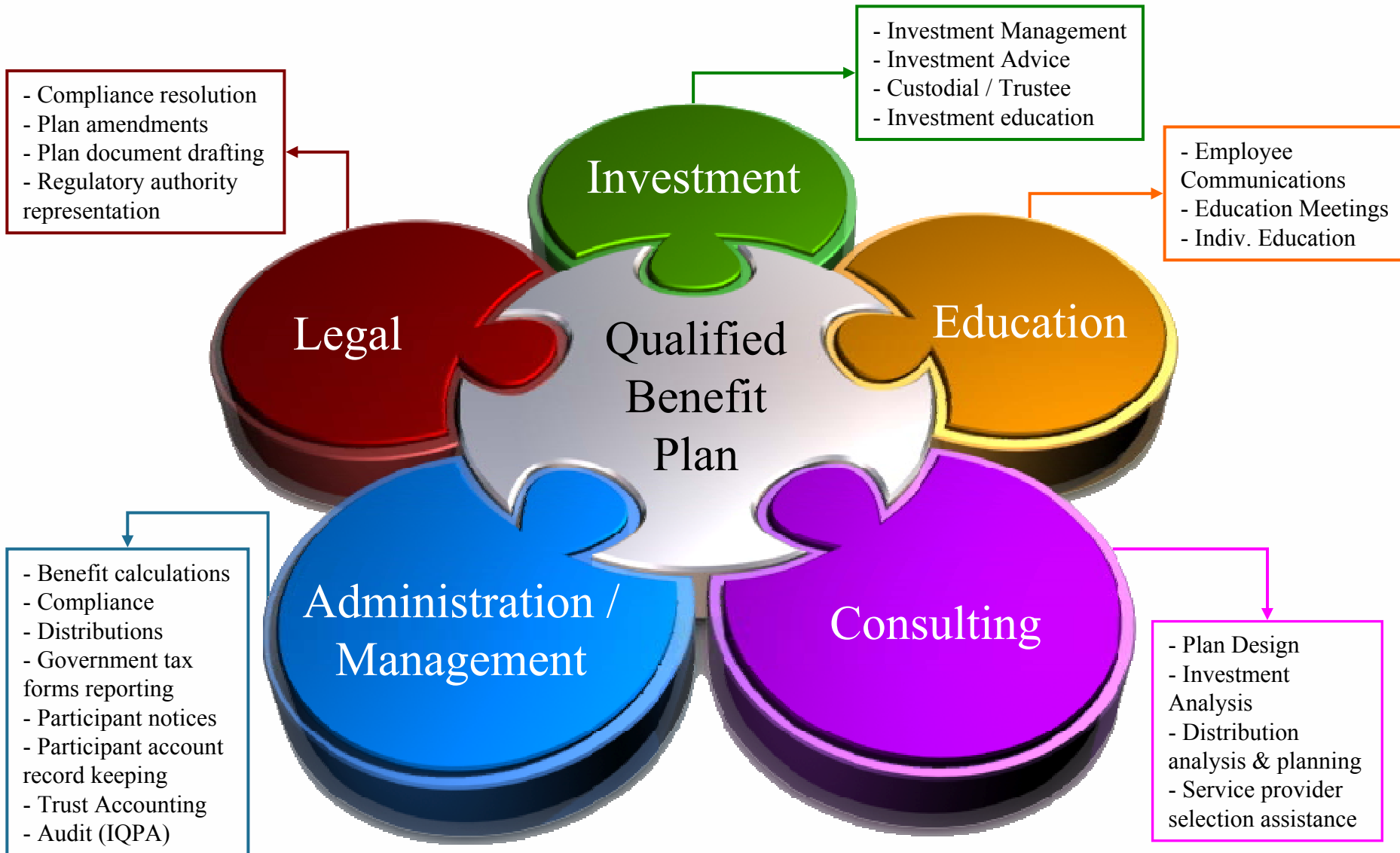
# Why Should You Care?

## Fee Basics

## Case Studies

## Conclusions

# Fee Basics



# Fee Basics



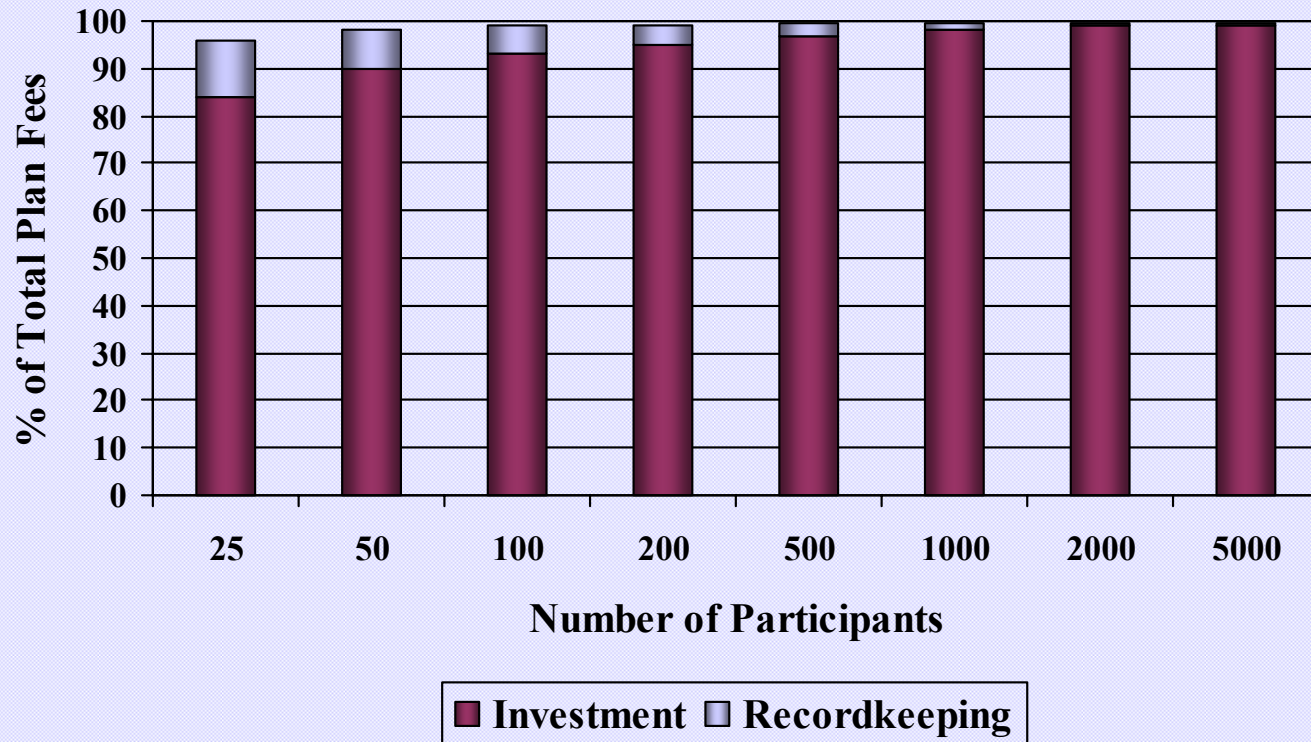
Admin / Management	Consulting	Participant Education	Investment	Legal
<ul style="list-style-type: none"> <li>• Compliance</li> <li>• Recordkeeping</li> <li>• Participant Statements / Website</li> <li>• Audit (IQPA)</li> <li>• Trust/custody</li> </ul>	<ul style="list-style-type: none"> <li>• Plan Design</li> <li>• Investment Analysis</li> <li>• Provider Selection</li> <li>• Distribution Planning</li> </ul>	<ul style="list-style-type: none"> <li>• Employee Communication Materials</li> <li>• Educational Meetings</li> <li>• Individual Education</li> </ul>	<ul style="list-style-type: none"> <li>• Asset Management</li> <li>• Investment Advice</li> <li>• Brokerage</li> </ul>	<ul style="list-style-type: none"> <li>• Plan Document Prep. and Review</li> <li>• Representation before IRS or DOL</li> <li>• Litigation / Negotiations</li> </ul>

% of Assets	<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>
Unit Charges	<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	
Time	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Flat Amount		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>





## GAO 401(k) Fee Report November 2006



Primary Plan “Cost Centers”: Investments and Recordkeeping



## Basic Service Categories:

1

Investment Management: buying / selling of specific assets based on stated objectives

2

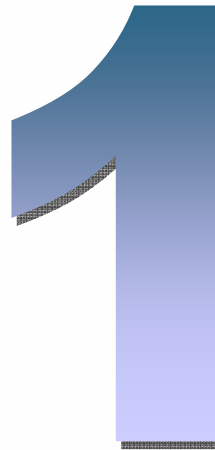
Investment Advice: fund selection and monitoring, participant asset allocation, education

3

Plan Administration and Recordkeeping: basic administration, recordkeeping, and trust and custody services



## Investment Management



# Fee Basics: Investment Management



<b>Investment Vehicle</b>	<b>% of Plans</b>
<b>Annuities</b>	8%
<b>Collective Trust Funds</b>	28%
<b>Mutual Funds</b>	91%
<b>Separate Accounts</b>	21%
<b>Other</b>	10%

Source: Deloitte's 2009 401(k) benchmarking survey



## Mutual Funds: Basics

What: Pooled assets invested to meet specific objectives

Who: Funds are run by investment companies or business trusts regulated by the SEC

How: The pooled assets are “unitized” allowing individual investors to purchase units or “shares”

When: open-ended funds continually sell shares; closed-ended funds sell a fixed # of shares



## Mutual Funds: Fees

1. Sales Loads: commissions charged upon purchase (front-end) or sale (back-end) of the fund
2. Ongoing Expenses: fund mgmt, admin, and distribution /sales costs - the “expense ratio”
3. Trading Costs: Fees associated with trading securities - commissions, market-maker spread, and market impact costs

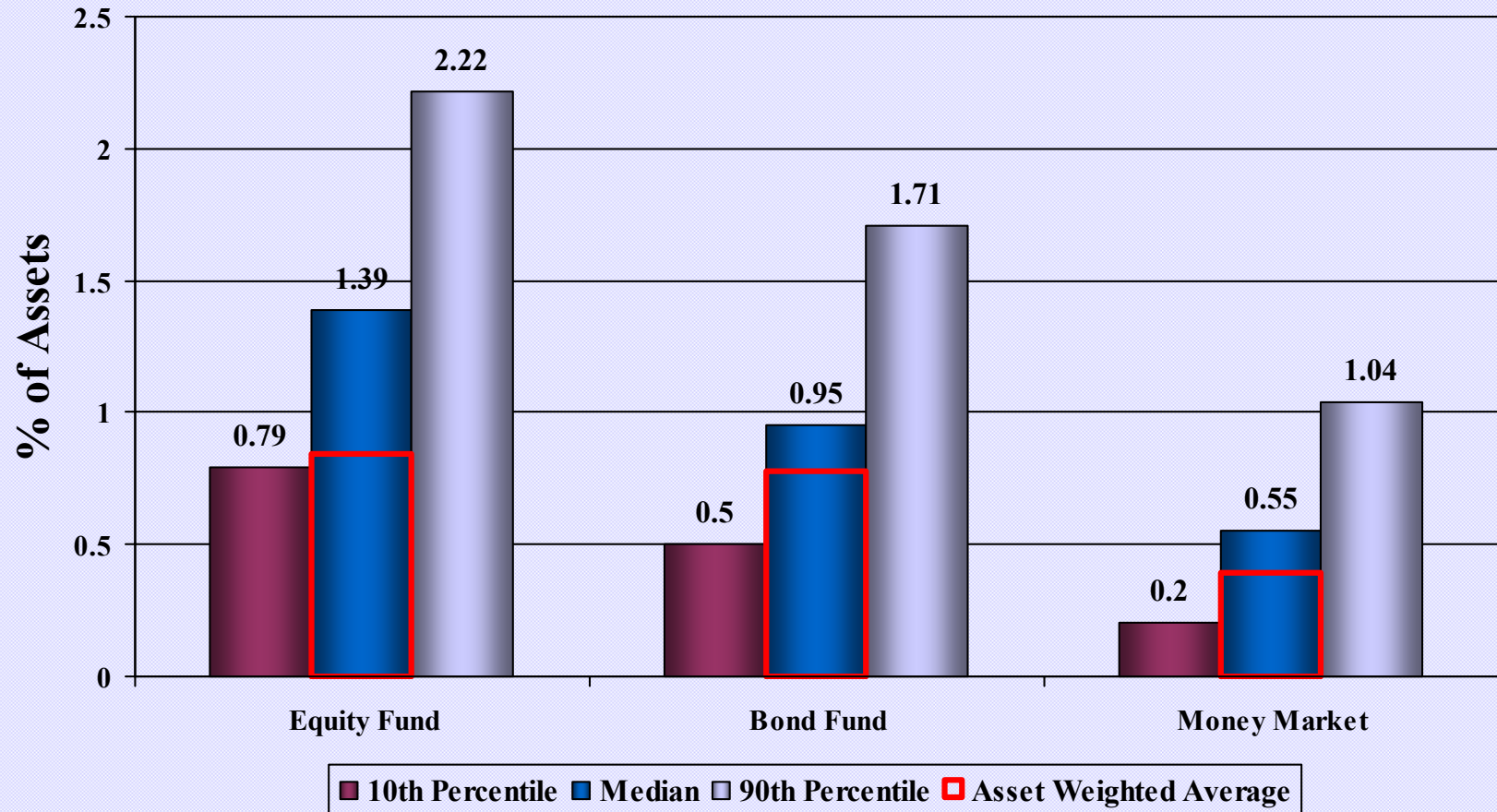


## Mutual Funds: Sales Loads (share classes)

<b>Share Class</b>	<b>Front-End Load</b>	<b>Back-End Load</b>	<b>Ongoing Sales Charge</b>
<b>A</b>	Yes, usually 4 - 6%	No	Yes, usually 0.25%
<b>B</b>	No	Yes, usually 4 - 6% “wasting”	Yes, usually 1.00%
<b>C</b>	No	Yes, usually 1% within 1 year	Yes, usually 1.00%
<b>R</b>	No	No	Yes, varies



## Mutual Fund Expense Ratios



Source 2009 Investment Company Fact Book



## Mutual Funds: Obtaining Fee Information

Mutual fund company websites...or...

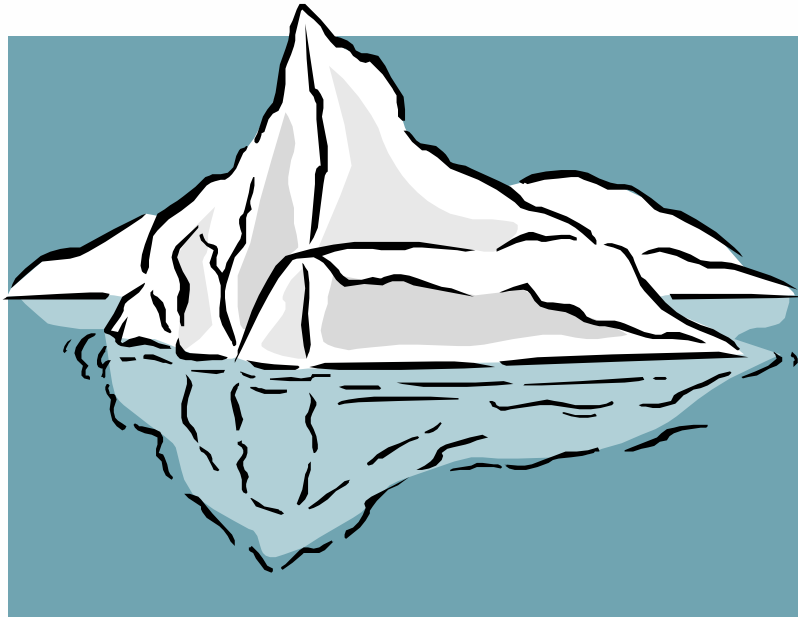
- <http://www.morningstar.com>
- <http://www.finra.org/fundalyzer/>
- <http://finance.yahoo.com/>

Fees & Expenses			
American Funds American Balanced A ABALX			
Fees and Expenses		07-29-09	
<b>Maximum Sales Fees %</b>			
Initial	5.75	Actual Fees %	
Deferred	None	12b-1	0.23
		Management	0.24
		Net Expense Ratio: Annual Report	0.59
<b>Redemption Fees %</b>			
	None	(As of 12-31-08)	
		Net Expense Ratio: Prospectus	0.61
<b>Maximum Fees %</b>			
Administrative	0.00	Expense Waivers:	
Management	0.42	Disclosure: Beginning April 1, 2005, the fund's investment adviser began waiving 10% of its management fees and this waiver is expected to continue at this level until further review.	
<b>Total Cost Projections</b> Cost per \$10,000			
3-Year	\$759		
5-Year	\$896		
10-Year	\$1293		

Fees & Expenses			
Russell LifePoints 2035 Strategy R2 RVLTX			
Fees and Expenses		03-01-09	
<b>Maximum Sales Fees %</b>			
Initial	None	Actual Fees %	
Deferred	None	12b-1	0.00
		Management	0.20
		Net Expense Ratio: Annual Report	0.25
<b>Redemption Fees %</b>			
	None	(As of 10-31-08)	
		Net Expense Ratio: Prospectus	1.11
<b>Maximum Fees %</b>			
Administrative	0.05	Expense Waivers:	
Management	0.20	Disclosure: RIMCo and Russell Fund Services Company ("RFSC"), have agreed to waive and/or reimburse the Funds for all operating expenses other than Rule 12b-1 distribution fees, shareholder services fees, the expenses of other investment	
<b>Total Cost Projections</b> Cost per \$10,000			
3-Year	\$524		
5-Year	---		
10-Year	---		



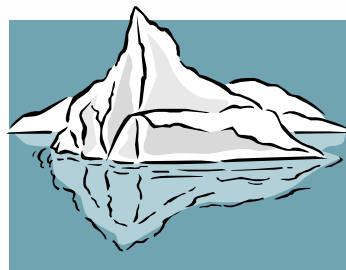
## Mutual Funds: Trading Costs





## Mutual Funds: Trading Costs

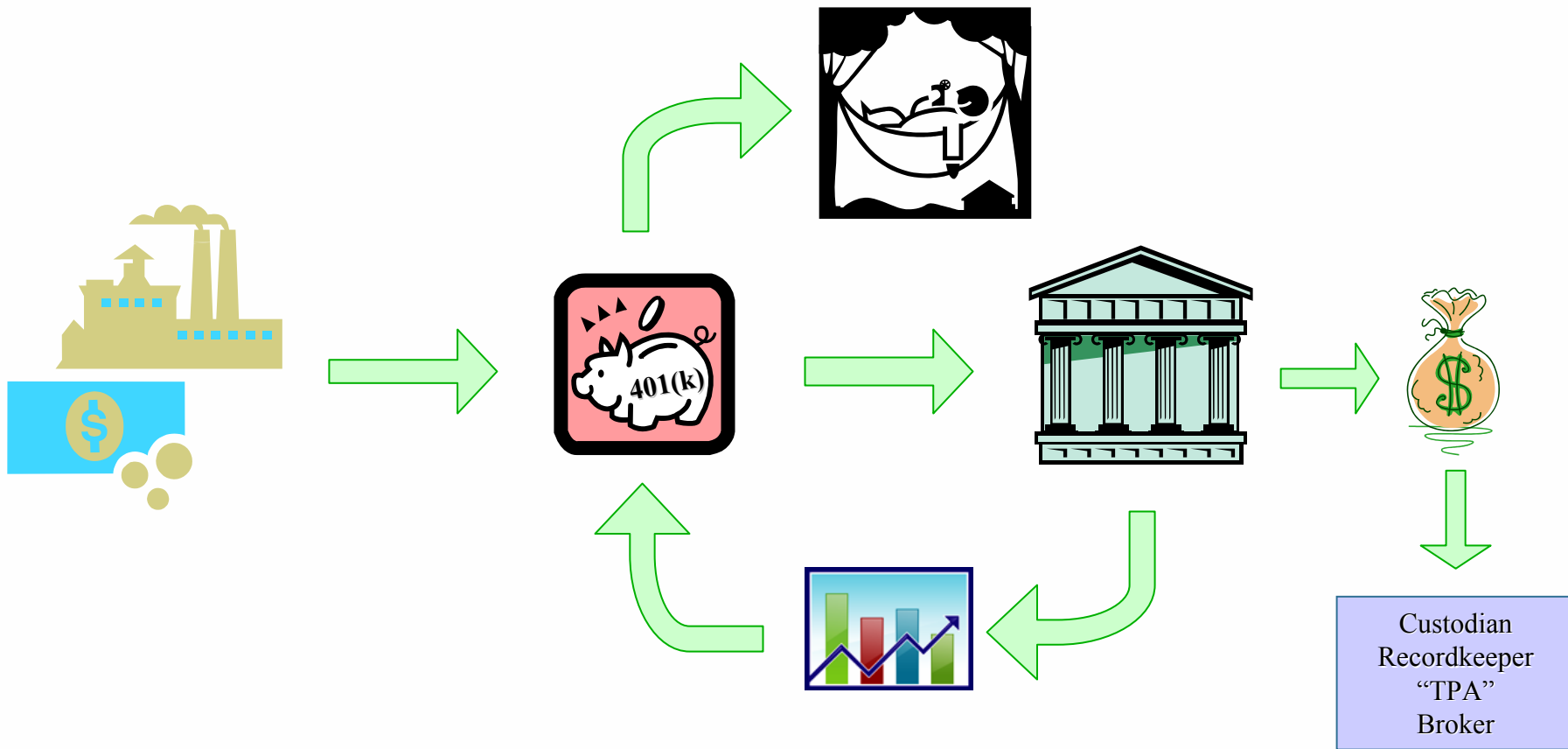
1. Rarely disclosed in prospectus or expense ratio
2. Comparable in magnitude to the expense ratio
3. Positively correlated to portfolio turnover
4. Negatively correlated to fund performance



Source: *Mutual Fund Trading Costs*, Chalmers Edelen and Kadlec, The Wharton School/Univ. Penn.



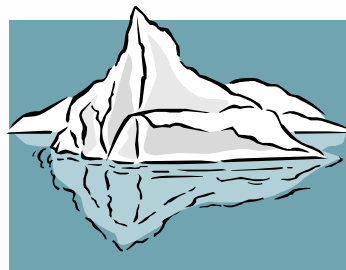
## Mutual Funds: Revenue Sharing





## Mutual Funds: Revenue Sharing

1. Various Names: Sub TAs / 12b-1s
2. Usually part of the expense ratio
3. Paid to brokers, custodians, and recordkeepers
4. Amounts range from 0% to approx. 1.3%





## Investment Advice

2



## Typical Services

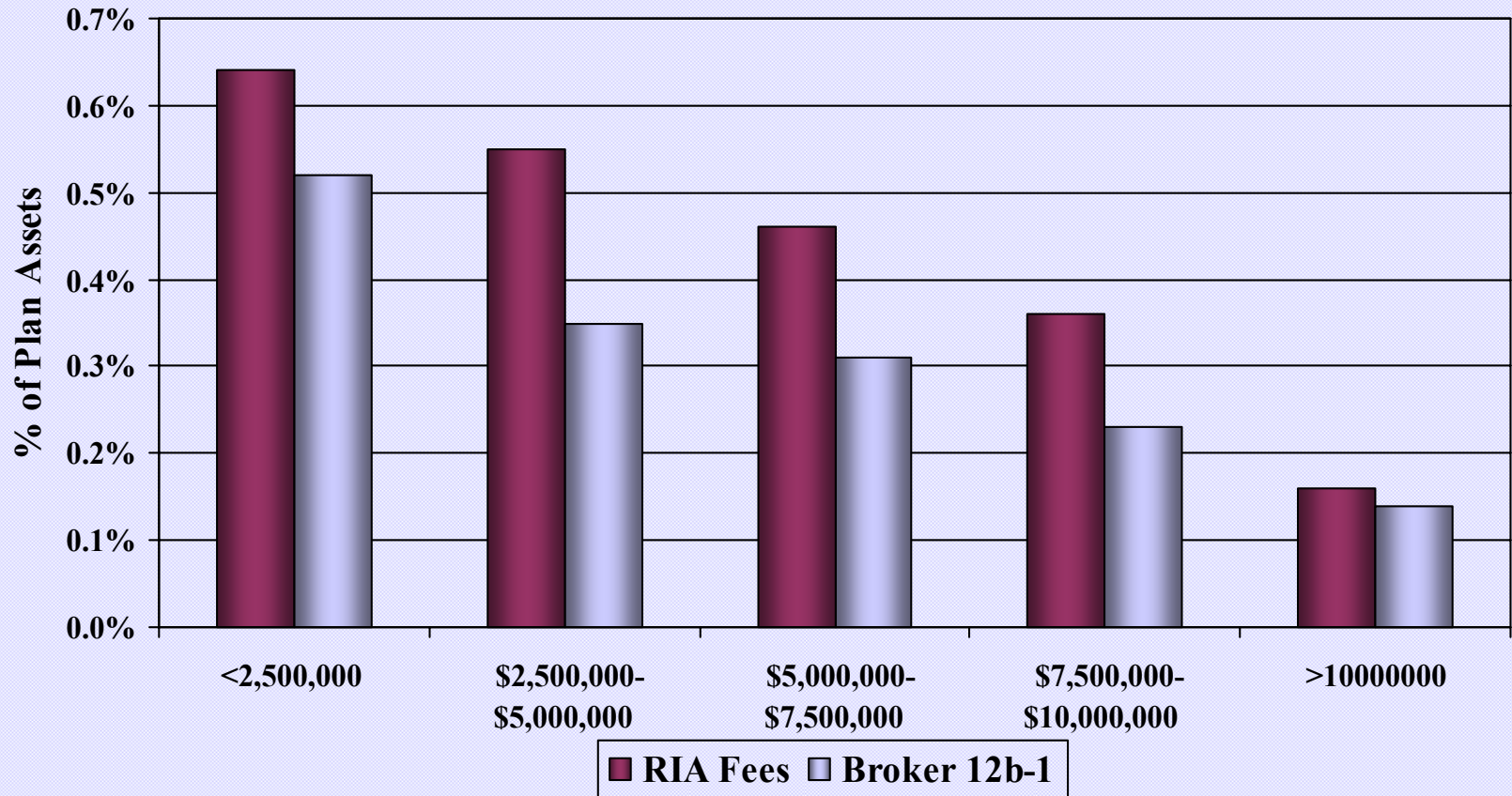
1. Investment Policy (asset allocation)
2. Fund Selection and Monitoring
3. Performance Reporting
4. Investment Education
5. Enrollment and/or Rollover Assistance

Fees: 12b-1 commissions paid by fund company to brokers,  
% of assets paid by plan to registered investment advisor

# Fee Basics: Investment Advice



**Average Fees for Investment Advice  
(Plans w/ >100 parts. in Pacific NW)**



Source: 2007 Form 5500

# Fee Basics: Investment Advice



## Obtaining Fee Information

### Form 5500 – Schedule A and C

<b>SCHEDULE C (Form 5500)</b> Department of the Treasury Internal Revenue Service Department of Labor Employee Benefits Security Administration Pension Benefits Guaranty Corporation		<b>Service Provider Information</b> This schedule is required to be filed under section 104 of the Employee Retirement Income Security Act of 1974. File as an attachment to Form 5500.		Official Use Only OMB No. 1210-0110 <b>2007</b> This Form is Open to Public Inspection	
For the calendar plan year 2007 or fiscal plan year beginning <b>January 01, 2007</b> and ending <b>December 31, 2007</b>					
<b>A</b> Name of plan A & A SAFETY INC. 401K RETIREMENT PLAN			<b>B</b> Three digit plan number 001		
<b>C</b> Plan sponsor's name as shown on line 2a of Form 5500 A & A SAFETY INC.			<b>D</b> Employer Identification Number 31-1035771		
<b>Part I Service Provider Information (see instructions)</b>					
<b>1</b> Enter the total dollar amount of compensation paid by the plan to all persons, other than those listed below, who received compensation during the plan year.				1	\$118
<b>2</b> On the first item below list the contract administrator, if any, as defined in the instructions. On the other items, list service providers in descending order of the compensation they received for the services rendered during the plan year. List only the top 40. 103-12 IEs should enter N/A in columns (c) and (d).					
(a) Name		(b) Employer identification number (see instructions)	(c) Official plan position		
PRINCIPAL LIFE INSURANCE COMPANY		42-0127290	INVESTMENT ADVISORY		
(d) Relationship to employer, employee organization, or person known to be a party-in-interest		(e) Gross salary or allowances paid by plan	(f) Fees and commissions paid by plan	(g) Nature of service code (s) (see instructions)	
INVESTMENT			\$12,645	20	

<b>SCHEDULE A Form 5500</b> Department of the Treasury Internal Revenue Service Department of Labor Employee Benefits Security Administration Pension Benefits Guaranty Corporation		<b>Insurance Information</b> This schedule is required to be filed under section 104 of the Employee Retirement Income Security Act of 1974. File as an attachment to Form 5500. Insurance companies are required to provide this information pursuant to ERISA section 103(a)(2).			Official Use Only OMB No. 1210-0110 <b>2007</b> This Form is Open to Public Inspection	
For the calendar plan year 2007 or fiscal plan year beginning <b>January 01, 2007</b> , and ending <b>December 31, 2007</b>						
<b>A</b> Name of plan A & A SAFETY INC. 401K RETIREMENT PLAN				<b>B</b> Three-digit plan number 001		
<b>C</b> Plan sponsor's name as shown on line 2a of Form 5500 A & A SAFETY INC.				<b>D</b> Employer Identification Number 31-1035771		
<b>Part I Information Concerning Insurance Contract Coverage, Fees, and Commissions.</b> Provide information for each contract on a separate Schedule A. Individual contracts grouped as a unit in Parts II and III can be reported on a single Schedule A.						
<b>1 Coverage</b>						
(a) Name of insurance carrier						
JOHN HANCOCK LIFE INSURANCE COMPANY (USA)						
(b) EIN	(c) NAIC code	(d) Contract or identification number	(e) Approximate number of persons covered at end of policy or contract year	Policy or contract year		
				(f) From	(g) To	
01-0233346	65838	67735	180	07/11/2007	12/31/2007	
<b>2 Insurance fees and commissions paid to agents, brokers, and other persons:</b>						
			<b>Totals</b>			
Amount of commissions paid			Fees paid / Amount			
\$39,660			\$9,909			



## Plan Administration and Recordkeeping

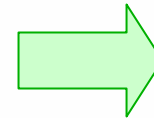
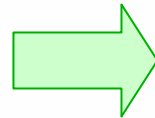
3



## Fee Calculations

### Input

- Plan type(s)
- Participants
- Plan assets
- Future flow



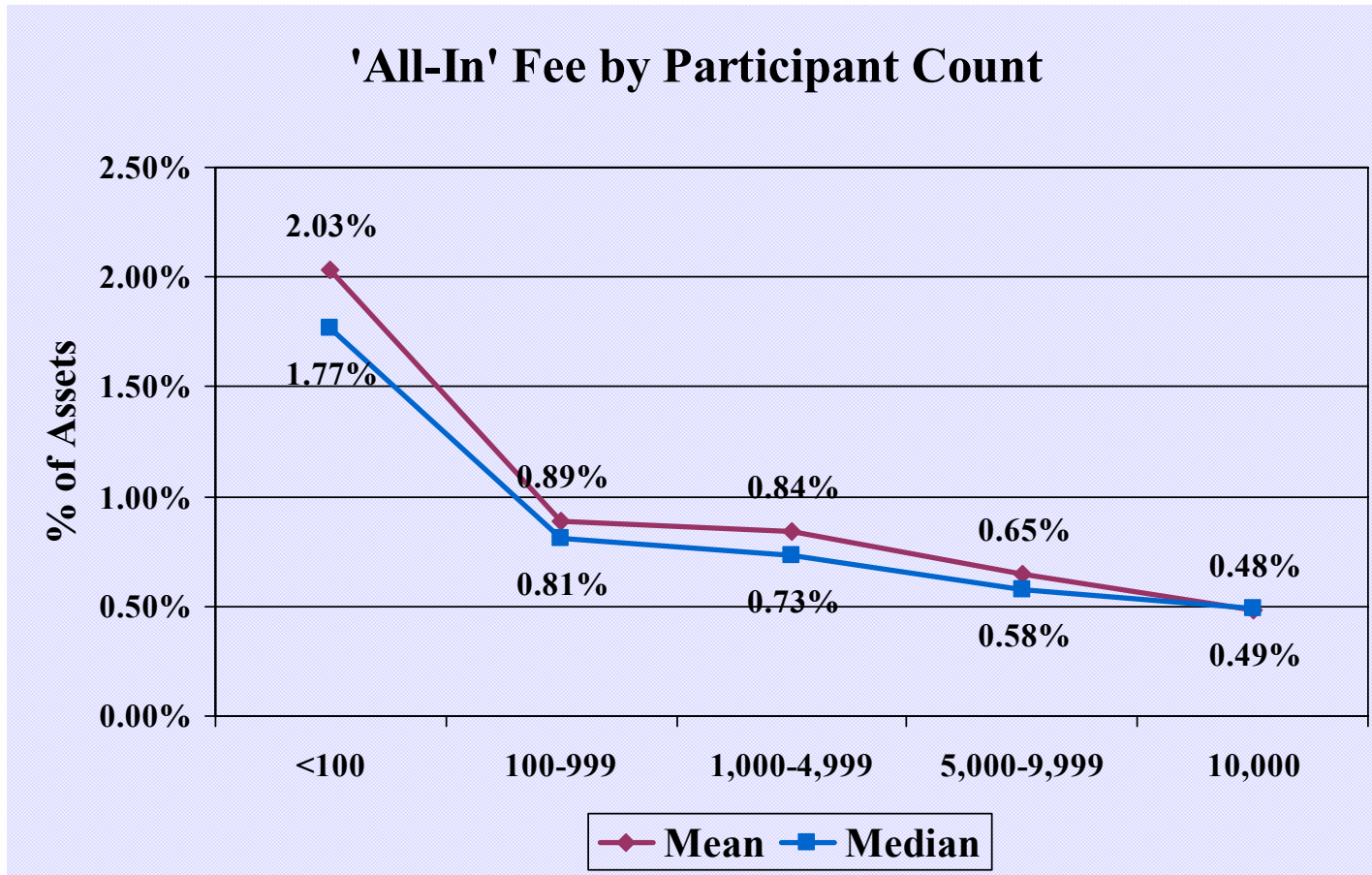
### Output

- Total \$
- \$ / Person
- % of Assets

All providers “calculate” the revenue needed to service a plan, but not all clearly disclose this data to the sponsor



## Fee Benchmarks?

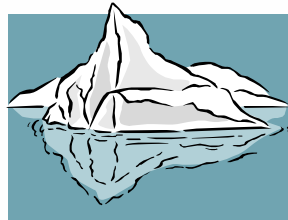


Source: Deloitte and ICI Defined Contribution / 401(k) Fee Study



## Annuity Wrap / Asset Based Fees

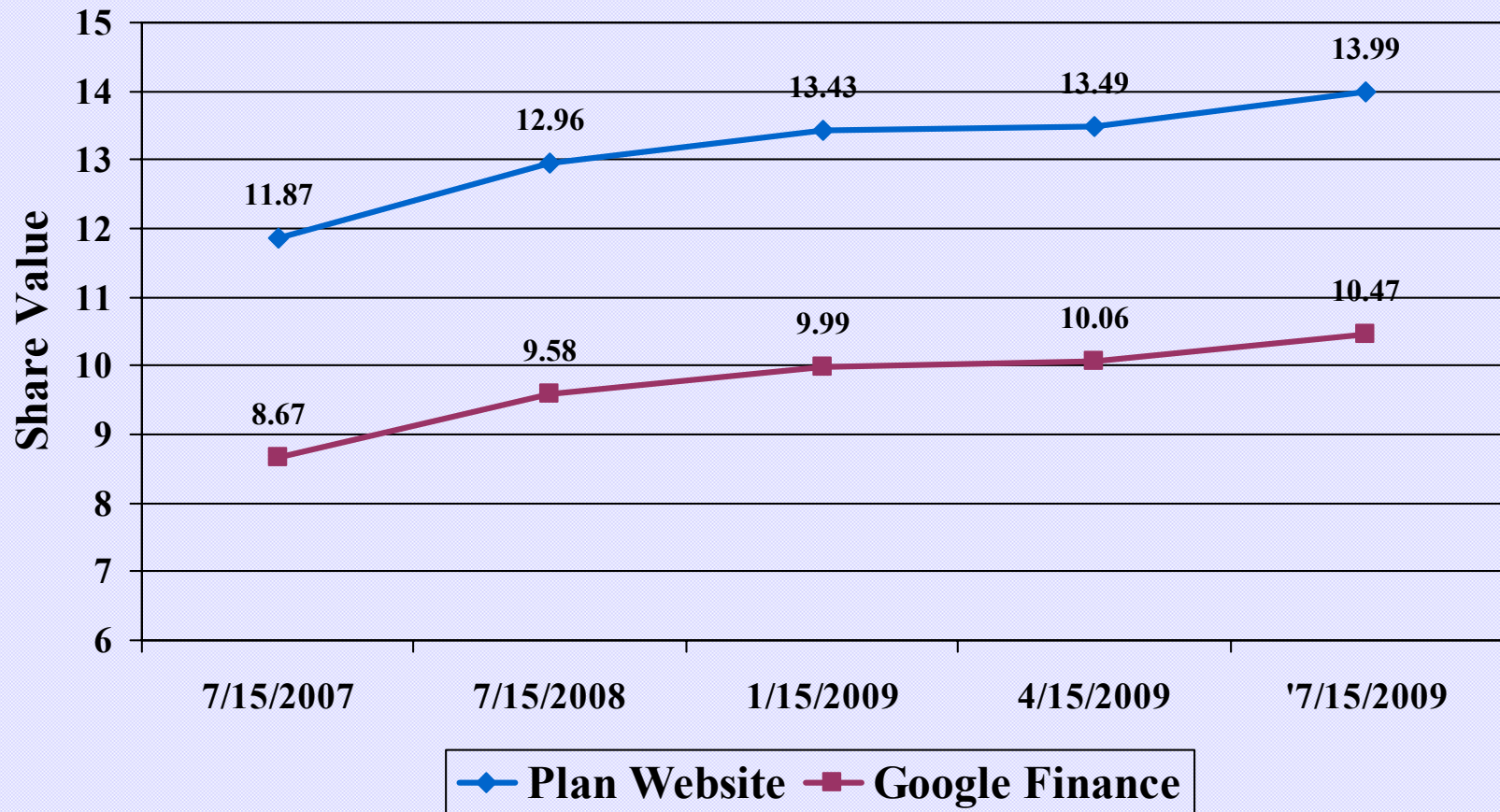
1. % of assets charged by insurance providers
2. Charged when revenue sharing isn't "enough"
3. Usually disclosed to sponsors at point of sale
4. Often not disclosed to participants
5. Incorporated into the fund's daily share value



# Fee Basics: Plan Admin and Recordkeeping



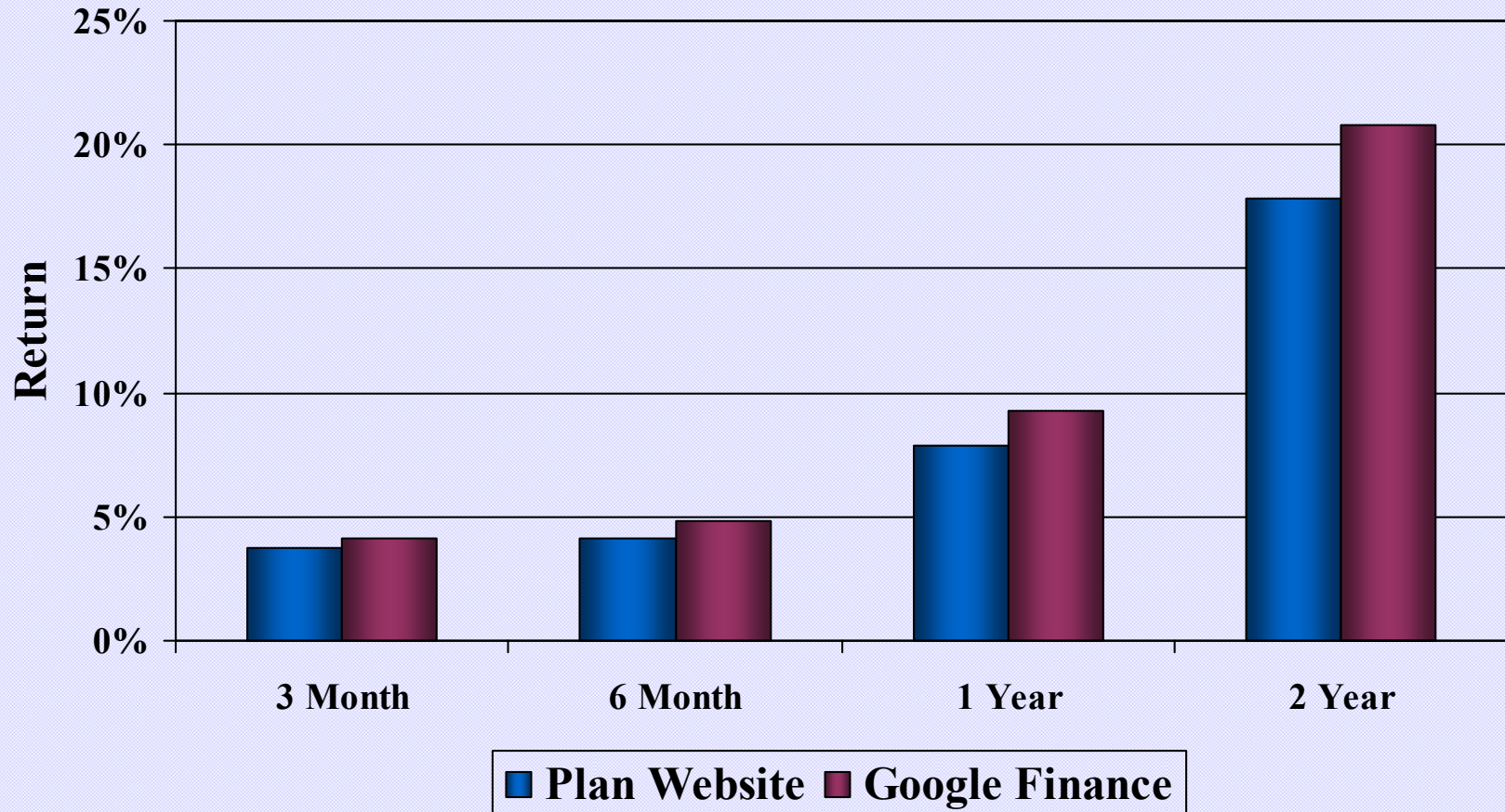
## Annuity Wrap / Asset Charge Example (PTRAX)



Source: Google Finance and presenters calculations



## Annuity Wrap / Asset Charge Example (PTRAX)



Source: Google Finance and presenters calculations



## Sidebar: Custody Fees

1. Typical custody fees: 5 bps to 12 bps

2. Additional Fees for “Extras”

- Pay agent services (e.g. \$15 / check)
- Self-directed brokerage accounts
- Corporate trustee service (e.g. \$2,500 / yr)

Note: Trade commissions apply to SDBAs, e.g.

- \$12.95 / stock trade
- \$49.95 / mutual fund



---

Why Should You Care?

Fee Basics

Case Studies

Summary and Questions

# Case Study 1



Plan Details			
<b>Type</b>	SEP IRA	<b>Assets</b>	\$800,000
<b>Participants</b>	15	<b>Flow</b>	\$125,000

“Disclosed” Fees			
<b>Admin</b>	\$12 contract charge	<b>Inv. Adv</b>	??
<b>Inv. Mgmt.</b>	??		

Actual Fees			
<b>Admin</b>	1.25% / \$10,012	<b>Inv. Adv</b>	0% / \$0.00
<b>Inv. Mgmt.</b>	0.84% / \$6,400	<b>Total</b>	<b>2.05% / \$16,412</b>



Contract included a 1.25% annuity wrap fee, plus a contingent deferred sales charge of up to 7%

# Case Study 2



Plan Details			
Type	401(k)	Assets	\$1,480,000
Participants	25	Flow	\$125,000

“Disclosed” Fees			
Admin	\$3,600 / year	Inv. Adv	??
Inv. Mgmt.	??		

Actual Fees			
Admin	0.65% / \$9,600	Inv. Adv	0% / \$0.00
Inv. Mgmt.	0.48% / \$7,100	<b>Total</b>	<b>1.13% / \$16,700</b>



Mutual funds paid 0.41% in “revenue sharing” to cover “shareholder servicing”

# Case Study 3



Plan Details			
<b>Type</b>	401(k)	<b>Assets</b>	\$5,200,000
<b>Participants</b>	94	<b>Flow</b>	\$500,000

“Disclosed” Fees			
<b>Admin</b>	\$0 / year	<b>Inv. Adv</b>	0.55% / \$28,600
<b>Inv. Mgmt.</b>	0.96% / \$50,120	<b>Total</b>	1.61% / \$78,720

Actual Fees			
<b>Admin</b>	<i>0.30% / \$15,600</i>	<b>Inv. Adv</b>	0.55% / \$28,600
<b>Inv. Mgmt.</b>	0.66% / \$34,520	<b>Total</b>	1.61% / \$78,720



Mutual funds paid 0.30% in “revenue sharing” to cover shareholder servicing

# Case Study 3 – Revenue Sharing Issues



	Participant 1	Participant 2
<b>Fund</b>	Moderate Allocation	Target Date
<b>Account Balance</b>	\$100,000	\$100,000
<b>Expense Ratio</b>	0.53%	1.04%
<b>“Revenue Sharing”</b>	0.08%	0.43%
<b>Admin Fees</b>	$\$100,000 \times 0.08\% = \mathbf{\$80}$	$\$100,000 \times 0.43\% = \mathbf{\$430}$



**Beware of target date funds, it's common practice to add to fund lineup because of revenue sharing**



---

Why Should You Care?

Fee Basics

Case Studies

Summary and Questions



# Summary

1. You need to pay attention to plan fees

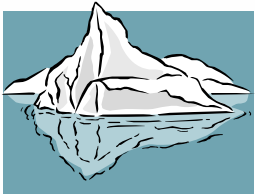
2. Providers have incentive (and ability) to hide admin and recordkeeping fees in investment fees

3. Get total cost broken down into three categories

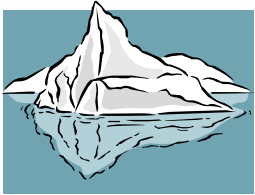
- Investment Management
- Investment Advice
- Administration and Recordkeeping



# Three Icebergs to Lookout For:



1. Mutual Fund Trading Costs



2. Revenue Sharing



3. Annuity Wrap or Asset Based Fees



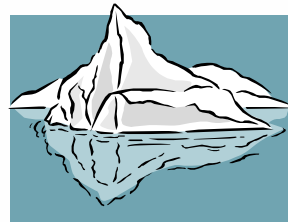
# Conclusion

*“I’d rather know some of the questions  
than all of the answers.”*

- James Thurber

*“The ability to ask the right question is more than  
half the battle of finding the answer.”*

-Thomas J. Watson



# Questions





**SPECTRUM**

PENSION CONSULTANTS

# Thank You!

Spectrum Pension Consultants, Inc.

6402 19<sup>th</sup> Street West

Tacoma, WA 98466

253.565.2100 - Phone

253.566.9440 - Fax

[www.spectrumpension.com](http://www.spectrumpension.com)

Copyright © 2009 Spectrum Pension Consultants, Inc. All rights reserved.