Defined Contribution Plans
Plan Sponsor Focus: DC Plan Fees

Factors behind the focus on retirement plan fees:

Fee disclosure regulation: Since 2012, service providers have been required to fully disclose all direct and indirect fees to both plan sponsors and participants. While the effectiveness of this effort is up for debate, fee disclosure regulations have helped bring attention and transparency to fees in DC plans.

Lawsuits targeting excessive fees: Ongoing high profile lawsuits which have garnered significant media attention have helped shine a spotlight on DC plan fees. These lawsuits have mostly been directed at large, multi-billion dollar corporate plans which have the potential for large settlements. Recently, these lawsuits have migrated to the 403(b) / non-profit space with high profile universities being the latest target.

Department of Labor (DOL) fiduciary rule: The DOL fiduciary rule begins to take effect in April 2017. This will require an industry wide fiduciary standard with certain exemptions. This development should hasten the trend of increased fee transparency and the adoption of lower cost vehicles.

Components of the DC Plan all-in fee:

The DC Plan all-in fee is the total cost for maintaining the plan including administration, investment management, and fiduciary oversight. With regard to administration, every plan works with a retirement service provider(s) to facilitate services such as recordkeeping, communications, education, and compliance and audit support. The investment management component is the cost associated with the management of the investment options within the plan lineup. The asset class, vehicle type, and share class in the case of mutual funds has a significant impact on the plan's overall fee level. Finally, the fiduciary oversight portion consists of the cost for financial advice. This may include an investment consultant and/or an advice platform that is bundled with the plan. Any costs associated with committee oversight and legal assistance would be included in this segment as well.

Key fee drivers for DC Plans:

The plan asset size along with the number of participants and average account balance tend to be strong drivers of plan costs. From an administrative perspective, larger plans can be priced more competitively than smaller plans due to the scale that can be achieved by the retirement service provider. Larger plans also may be able to access more competitively-priced investment vehicles. Another factor correlated to plan costs is the plan's investment allocation with a larger allocation to equity funds tending to drive all-in costs higher. Finally, the retirement service provider structure also may impact plan fees depending on whether services are bundled under one provider or delivered by multiple parties. In addition, the service provider's business model (i.e. DC-focused, insurance-related) may also impact the fee level. A periodic fee review may help to drive plan costs lower and identify inefficiencies in the plan structure.

Participant fees:

There are two main approaches for assessing participant fees: revenue sharing and fee equalization (a combination of the two may be utilized as well). Revenue sharing is the practice whereby a portion of a fund's expense ratio is used to cover the plan's administrative costs. Revenue sharing often results in the uneven sharing of costs as it is dependent on the participant's investment selection. Also, in a revenue sharing arrangement, plan expenses are opaque for most participants as they are embedded as part of the expense ratio. Under a fee equalization approach, investment management fees and plan administration fees are segregated. The plan menu consists of institutional share classes to provide the lowest cost investment access. Plan expenses are charged directly to participant accounts in an equal or equitable fashion based on a dollar per head or asset-based fee.

Industry trends plan sponsors should be aware of:

Due to the increased focus on costs, expense ratios have continued to decline for 401(k) participants invested in mutual funds and this downward trend has accelerated especially over the last five years. In addition, the availability of index options continues to increase with a majority of plans now offering a core set of index options covering major asset classes. This allows participants the ability to invest in a low-cost manner and without assuming active manager risk if they so desire. Another major trend is the movement toward greater fee transparency with more plans opting for a fee equalization structure and less plans relying on revenue sharing as the primary means of assessing participant fees. Related to this development is the increasing utilization of institutional share classes as opposed to retail share classes within plan lineups. Institutional share class expense ratios do not provide any revenue sharing to the service provider to help offset plan expenses.

How can I reduce my fiduciary liability and act in the best interest of participants?

Plan sponsors should assess their plan in terms of governance, costs, and investments. With regard to governance, both a plan document and an investment policy statement should be maintained and reviewed periodically to ensure compliance with the administration of the plan. An investment committee also should be formed to oversee the plan. The committee should meet regularly and meeting minutes should be kept as a matter of record. A plan sponsor may consider retaining an investment consultant to help monitor the plan and provide advice regarding plan decisions.

Plan costs need to be monitored for reasonableness and competitiveness. Service provider fees should be appropriate based on the size and complexity of the plan. In addition, the plan sponsor should have a thorough understanding of the fee payment arrangement. Plan sponsors should seek to move toward a fee payment structure that is transparent and fair to all participants. Investment fees should be appropriate based on the asset class, vehicle type, and asset level. Both service provider and investment fees should be benchmarked versus industry norms to ensure competitiveness and plan fees should be disclosed to participants on an annual basis.

The investment lineup should have an open architecture structure with access to the full universe of competitive investment options and not constrained by the service provider's own proprietary offerings. The investment lineup also should be diversified across the asset class and risk spectrum. This includes the availability of passively-managed options as well as age-appropriate target date funds which can function as an appropriate qualified default investment alternative (QDIA). Finally, it is important that the vehicle type and/or share classes utilized within the lineup are aligned with the asset level of the plan.

A sound process equals defensibility. While there is no way to fully prevent potential legal action, plan sponsors need to have a sound governance process in place for fulfilling their fiduciary duty under the law. In addition, plan sponsors need to be able to justify fees based on the costs to administer the plan and these costs need to be reasonable and competitive versus peers and appropriate based on the asset level of the plan. Lower costs and greater transparency help reduce fiduciary liability for the plan sponsor and improve retirement readiness for participants.

Concord is happy to engage in further discussion around defined contribution plans and answer any questions you may have.

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