



# Recent Trends in Retirement Plan Fee Structures

The Days of Hiding the Acorn May be Over

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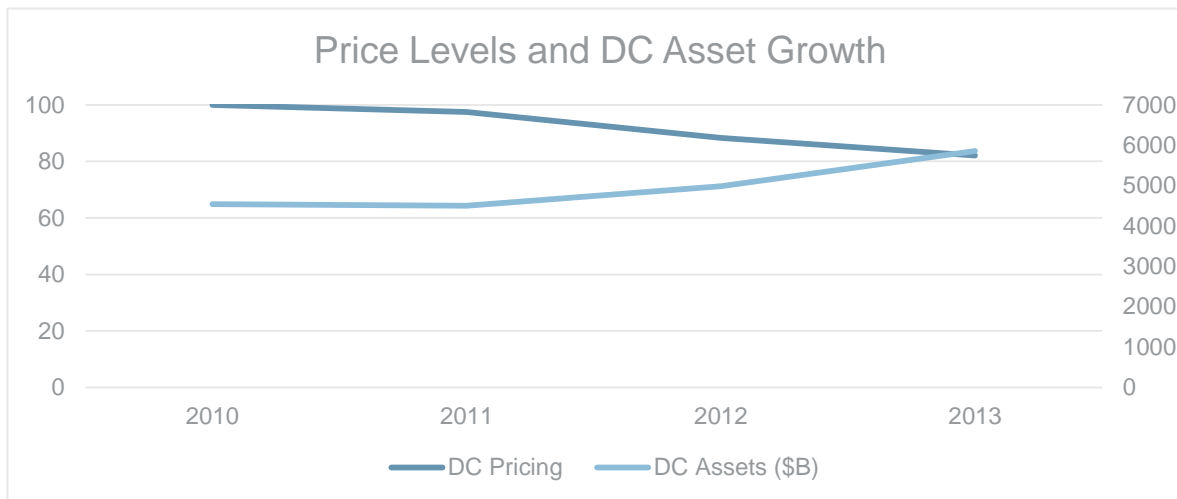
Prior to founding the Multnomah Group in 2003, Erik served as a Vice President of Retirement Services and led the Portland, OR practice of a national retirement services firm. In that position Erik was a founding member of the firm's national Investment Committee and had oversight for business development in the western United States.

Erik is a member of the CFA Institute, the CFA Society of Portland, the CFA Society of Seattle, the American Society of Pension Professionals and Actuaries, the Portland Chapter of the Western Pension & Benefits Council, and the Society for Human Resource Management. Erik holds a B.B.A. from the University of Iowa.

# Fee Compression Slowing, Fee Structures Changing

On an annual basis, Multnomah Group prepares fee benchmarking studies for its defined contribution retirement plan clients. The purpose of the fee benchmarking study is to evaluate the fees incurred for:

- Recordkeeping
- Administration
- Custody
- Employee Communication



- 18% decline in DC pricing
- 29% increase in DC assets

*Price levels based on the Multnomah Group 2014 Fee Benchmarking Study*

*Asset levels from the Investment Company Institute 2014 Investment Company Fact Book*

# Factors for Fee Compression

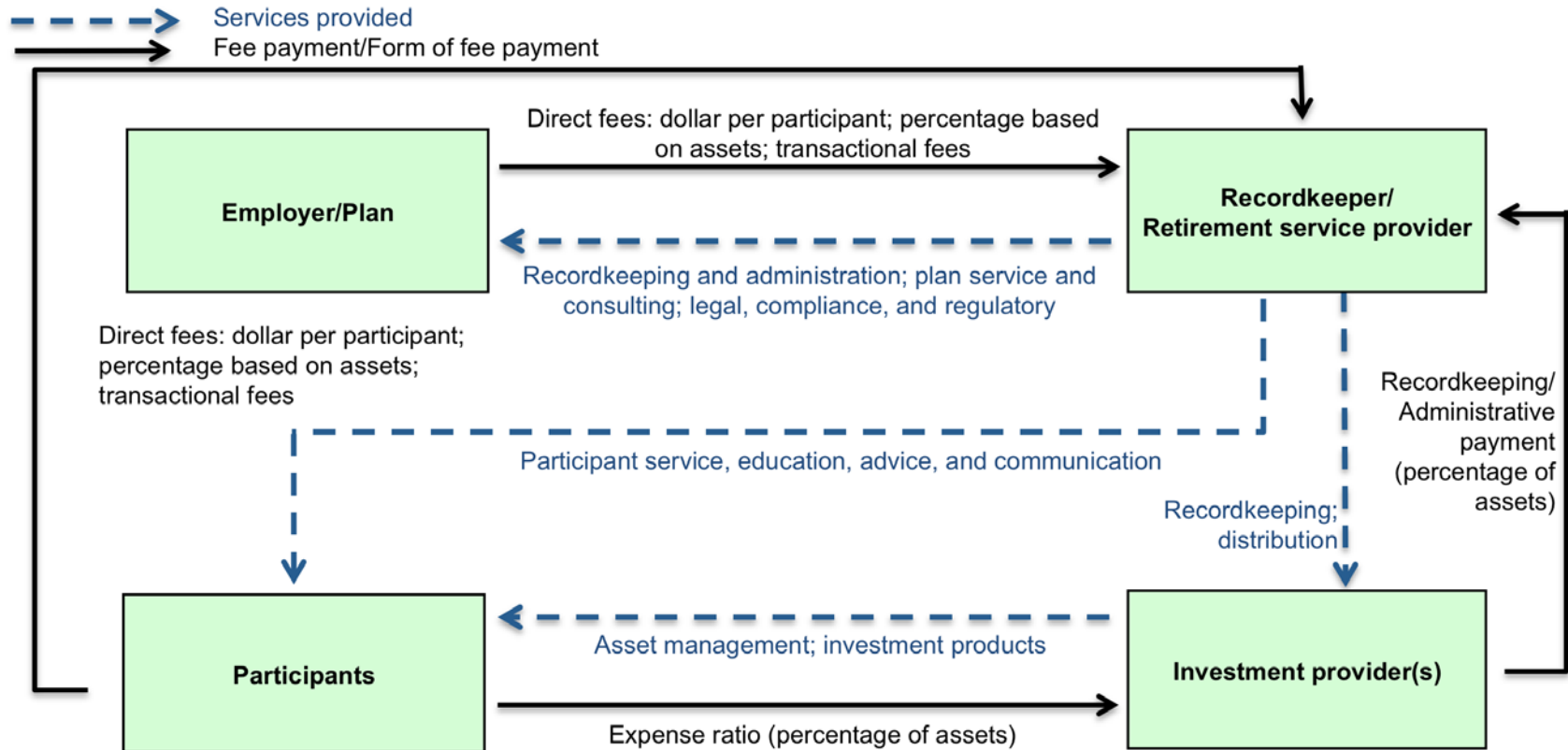
- 40 recordkeepers in 2006 / 27 in 2014<sup>1</sup>
- Enhanced Client and Participant Fee Disclosure
  - Schedule C disclosures in 2009
  - 408(b)(2) Covered Service Provider disclosures in 2012
  - 404(a)(5) Participant fee disclosures in 2012
- Increased Legal Action
  - Tibble v. Edison International
  - Tussey v. ABB
  - Bilewicz v. FMR LLC
- Increased Audit Activity<sup>2</sup>
  - \$599.7 M in Recoveries
  - 3,928 Civil Investigations Closed / 64.7 with Results
  - 365 Criminal Investigations Closed / 106 Indictments

<sup>1</sup>Callan Associates

<sup>2</sup>US Department of Labor Employee Benefits Security Administration Fact Sheet

# Understanding of Fee Structures Remains Poor

**Figure 7.12**  
**A Variety of Arrangements May Be Used to Compensate 401(k) Service Providers**



Note: In selecting the service provider(s) and deciding the cost-sharing for the 401(k) plan, the employer/plan sponsor will determine which combinations of these fee arrangements will be used in the plan.

Source: ICI Research Perspective, "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2012"

# Fee Fairness, Next Shoe to Drop

While compression is compelling, how fees are paid remains a challenge

- Participant vs. Sponsor
- Asset Based vs. Per Capita
- Holders of Fund A vs. Holders of Fund B
- Plan Expense Reimbursement Accounts
- “ERISA” Accounts

# Trends in Retirement Plan Pricing

1. Fee Equalization
2. Per-Capita Fee Structures
3. Increasing Transaction Fees
4. Vendor Focus on Cross-Sell Opportunities

# Fee Equalization

Plan recordkeeping and administrative fees are often offset (either in whole or in part) by “revenue sharing” payments from the investment products available within the investment menu of the plan.

- Revenue sharing can vary widely among the investment products within the investment menu
  - Active vs. Passive
  - Share Class Selection
- As a result some participants will pay more and some less as a percentage of their total plan assets despite receiving the same services from the recordkeeping provider



# Fee Equalization

Simple three fund investment menu at a service provider assuming a revenue requirement of 0.20%

## Pre and Post Fee-Equalization

	Revenue Sharing Model (Old)				Fee-Equalization Model (New)			
Mutual Funds	Expense Ratio	Revenue Sharing	Expense / (Credit)	Participant Cost of Ownership	Expense Ratio	Revenue Sharing	Expense / (Credit)	Participant Cost of Ownership
Stock Fund A	0.98%	0.40%	0.00%	0.98%	0.98%	0.40%	(0.20%)	0.78%
Money Market Fund A	0.42%	0.20%	0.00%	0.42%	0.42%	0.20%	0.00%	0.42%
Bond Fund A	0.46%	0.03%	0.00%	0.46%	0.46%	0.03%	0.17%	0.63%

# Fee Equalization

## Pros

- Creates fee “equity”- all participants pay the same percentage of their assets
- Investment products that need to be changed are not complicated by vendor revenue requirements

## Cons

- Transition can be complicated and will create “winners and losers” with increasing or decreasing expense ratios
- Complicates 404(a)(5) disclosures
- Frequently requires unitization of mutual fund investments
- May be complicated from a recordkeeper perspective

# Per Capita Fee Structures

Recordkeeping and administration service workload have a low correlation to plan assets

- From January 1, 2009 through September 30, 2014 the S&P Index has delivered a nearly 150% return
- Participant growth has been much more muted

Mechanics:

- Reduce all investment products to their lowest cost share class
  - Preferably with no revenue sharing
  - Negotiate a per capita fee structure with your service provider
  - Either pass through the per capita fee or have it paid by the plan at the participant level

# Per Capita Fee Structures

## Pros

- Creates fee “equity” - all participants pay the same dollar amount for plan services
- Highly transparent and easy to understand
- Investment products that need to be changed are not complicated by vendor revenue requirements
- Fee escalation is decoupled from investment performance or contribution levels

## Cons

- Transition can be complicated and participants will require education in the transition from opaque to transparent pricing
- Pricing volatility for low average account balance plans with high turnover
- Potential obstacle to enrollment for participants with low account balances

# Increasing Transaction Fees

Fee compression and changing models have reduced the revenue “upside” for providing services to retirement plans

- Increasing utilization of project fees for fund changes and plan amendments
- Increasing participant fees
  - Loans
  - Hardship Withdrawals
  - QDROs
  - Distributions

Transaction level fees are subject to much less scrutiny and negotiation

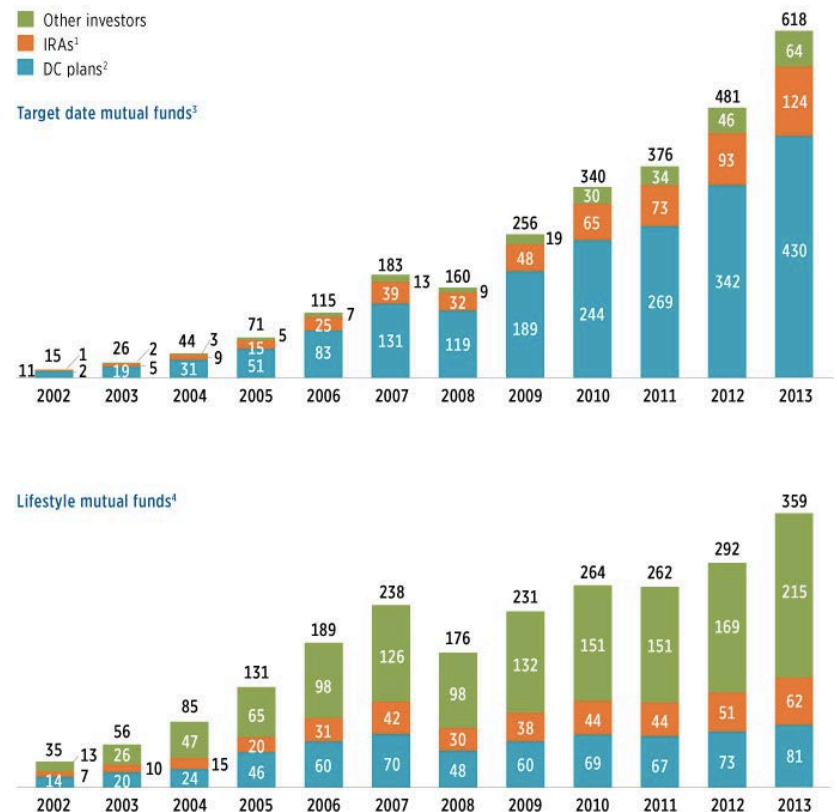
# Vendor Focus on Alternative Revenue Streams

## Proprietary Asset Management

“...affiliated funds are less likely to be removed from the menu relative to unaffiliated funds, independent of their performance record.”

It Pays to Set the Menu: Mutual Fund Investment Options in 401k plans.

Finance and Economics Discussion Series. Division of Research & Statistics and Monetary Affairs Federal Reserve Board, Washington, D.C.



# Vendor Focus on Alternative Revenue Streams

## General Account Offerings as Cash Alternatives

- Low money market returns
- No fixed expense (spread income)
- Liquidity restrictions make recordkeeping business more “sticky”

## Managed Account Programs

- Reduced pricing for auto-enrollment into managed account programs
- Materially higher net margins
- Outside account consolidation opportunities
- Higher retention of rollovers

## Decumulation

- Guaranteed income solutions
- Annuitization
- Higher retention of rollovers
- Insurance product margins

# Next Steps

1. Understand your fee structure
  - How much and who
2. Develop a Fee Policy Statement
  - Philosophy
  - Mechanics
  - Method for Continuing Assessment
3. Negotiate with your Provider to Bridge the Gap
  - Search activity has been low
  - Clients have significant fee leverage
4. Go to Search
  - If your vendor can't accommodate your needs, another vendor will



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