Pension Plan Fix-It Handbook

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GAO: Many 401(k) Plan Sponsors Don't Understand Fees, Revenue-sharing

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A finding in a recent U.S. Government Accountability Office study that smaller 401(k) plans pay higher fees as a percentage of plan assets is nothing new and somewhat intuitive, given that smaller plans tend to have smaller total plan assets.

Perhaps also not surprising but of some concern, though, is the fact that many plan sponsors still do not understand the fees charged their plans. The GAO study, *401(k) Plans: Increased Educational Outreach and Broader Oversight May Help Reduce Plan Fees*," found that while Schedule C was revised to provide reporting of direct and indirect compensation, U.S. Department of Labor letters sent to plan sponsors questioning Schedule C entries or lack of them add evidence that plan sponsors do not fully understand plan fees. This column will present some of the study's key findings.

Background

The 401(k) plan is the predominant defined contribution plan, covering more than 60 million U.S. workers, with assets totaling more than $2.4 trillion. Uncertainty surrounds fees paid and the expertise of plan sponsors, especially regarding small and medium-sized plans.

The GAO study collected information on the following:

- How much do plan sponsors and participants pay for services?
- What, if any, challenges do sponsors face in understanding how fees are charged?
- What has DOL done to help plan sponsors?

A survey was sent to 1,000 plan sponsors selected from the 2009 Form 5500 database. The survey was stratified into five groups:

- fewer than 10 participants;
- 10-49 participants;
- 50-99 participants;
- 100-499 participants; or
- 500 + participants

The survey results were analyzed by three groups: fewer than 50 participants, 50-499 participants and 500 or more participants. The survey was supplemented by review of investment reports submitted by plan sponsors as well as third-party fee reports.

See *Plan Fees*, p. 2

Plan Fees (continued from p. 1)

The Report

Service providers can charge an array of fees depending on the services provided, including:

- management fees;
- 12b-1 fees;
- sub-transfer agent fees (sub-TA);
- trading or transaction costs; and
- wrap fees in the case of annuity products

Understanding the fee structure also can be complicated by revenue-sharing — generally indirect payment made from one service provider to another in connection with services rendered to the plan. It is no wonder that plan sponsors, especially small ones, have difficulty identifying and understanding all the fees involved in administering a 401(k) plan.

Survey Results

- Larger plans are more likely than small plans to pass recordkeeping and administrative fees along to participants.
- Twenty-one percent of sponsors reported that either they or their participants paid for trustee, legal or audit services; 22 percent reported that the service provider waived these fees and 29 percent didn't know if their plans paid these fees.
- About 50 percent of plans' survey respondents did not know if they or their participants paid investment management fees, or believed these fees were waived. Not knowing who paid investment management fees was more prevalent among the plans with fewer than 50 participants.
- Many plan sponsors did not ask their providers for information on 12b-1 fees, sub-TA fees, excess commissions, trading/transactions fees and wrap fees (See Box 1).
- Some plan sponsors do not understand revenue-sharing, and the survey revealed that 48 percent of plan sponsors do not know if their service provider had a revenue-sharing agreement with other service providers. Of the plan sponsors that were aware of revenue-sharing, such arrangements either were not considered when selecting a service provider or details of the arrangements were not available. Revenue-sharing fees based on a percentage of plan assets, if not monitored, can result in overpaying for administrative services.
- Fees associated with insurance products, for example, group variable annuities, can be difficult for plan sponsors to identify and evaluate. (See Box 2.)
- Forty-eight percent of plan sponsors did not know if their plans incurred transaction costs; in fact, only 12 percent knew whether their plans incurred trading costs. The study noted that while the Securities and Exchange Commission has identified four major types of mutual fund transaction costs (commissions, spread costs, market impact costs and opportunity costs), no industrywide standard exists for calculating transaction costs.
- While noting the steps the DOL has taken regarding outreach, guidance and tools to help plan sponsors, many plan sponsors are either not aware of these DOL resources or do not use them. Many small employers do not have the time to research the information available and instead rely on their service providers; this dependence on an outside provider for awareness of fees can become a fiduciary issue.

Included in the GAO report is a five-minute video, *How Revenue Sharing Can Work, and Its Potential Impact on Participants' Account Balances*, and illustrative graphics that highlight the challenges plan sponsors face. (See Box 3.)

Box 1

Estimated Percentage of 401(k) Plan Sponsors Who Asked Their Providers about Certain Fees

Survey question: Have you asked your provider for information on these fees?	**Yes**	**No**
a. *Marketing and distribution fees, also known as 12b-1 fees,* may be used to pay commissions to brokers and other salespersons, for expenses such as advertising and other costs of promoting the fund to investors.	30	70
b. *Sub-TA fees,* which are typically fees used to reimburse a plan's record keeper for shareholder services that the fund would have otherwise provided, such as maintaining participant-level accounts and distributing the fund's prospectus.	19	82
c. *Excess commission, also known as SEC rule 28(e) soft dollars,* which are extra commissions charged by brokerage firms and paid to investment advisers and others—in the form of services other than execution of securities transactions, such as research products—for directing business to brokerage firms.	15	85
d. *Trading/transaction costs,* which include commissions associated with an investment manager's buying and selling of securities within a particular investment vehicle, such as a mutual fund. These are the costs associated with portfolio turnover.	20	80
e. *Wrap fees,* which are generally associated with annuities, are aggregate fees that encompass multiple components, such as investment management fees, surrender charges, mortality and expense risk charges, and administrative fees.	21	79

See *Plan Fees,* p. 3

GAO Recommendations

GAO recognizes the information and tools DOL developed, but recommends that alternative approaches be developed to actively engage plan sponsors in learning about plan fees and revenue sharing. In addition, the report says, DOL should allow easy public access to Form 5500 information as it relates to plan fees. An understanding of the term "fiduciary" in the context of plan-vendor service delivery structures is needed because many small employers rely on service providers that do not consider themselves fiduciaries, the report concludes.

What This Means

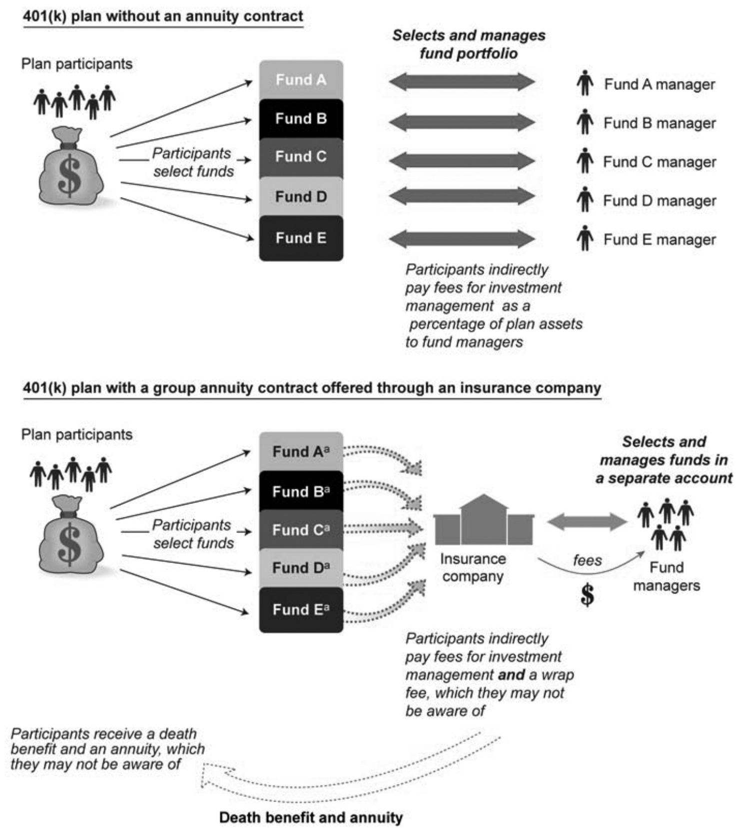
Despite government and service provider efforts, many plan sponsors still do not understand plan expenses. This is understandable and disconcerting: the fee arrangements can be complicated but plan sponsors must understand plan expenses and react soon to Section 408(b)(2) provider disclosures to plan sponsors that took effect July 1 and the Section 404(a)(5) plan sponsor disclosures to participants that will follow shortly.

If you are a service provider or a consultant to a plan sponsor, make sure your clients know what they are paying for! By now, you should have provided the necessary Section 408(b)(2) disclosures to your clients. Take the time to discuss every detail of the disclosure with them, as the regulations require it and your clients rely on you to provide them the information in this area that they need. Work with plan sponsors as they grapple with their Section 404(a)(5) disclosures.

If you are a plan sponsor, you must understand plan fees as well as the role (fiduciary or non-fiduciary) of the service provider. Get help if you need it.

Box 2

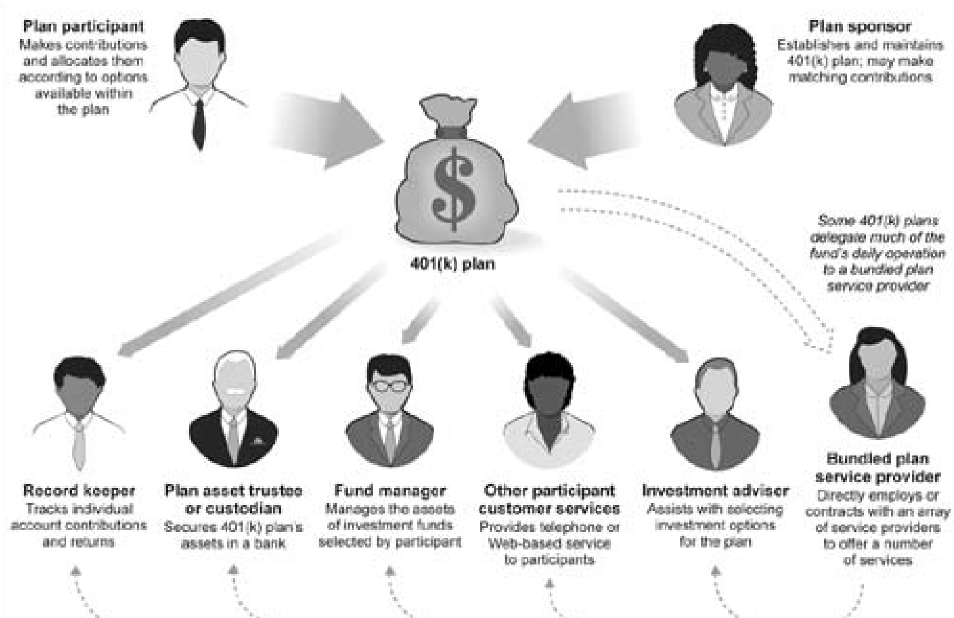
A Hypothetical Comparison of 401(k) Plans with and without Group Annuity Contracts



Source: GAO analysis of information from industry practitioners

Box 3

Structure of Service Provider Arrangements in 401(k) Plans



Source: GAO analysis of information from industry practitioners