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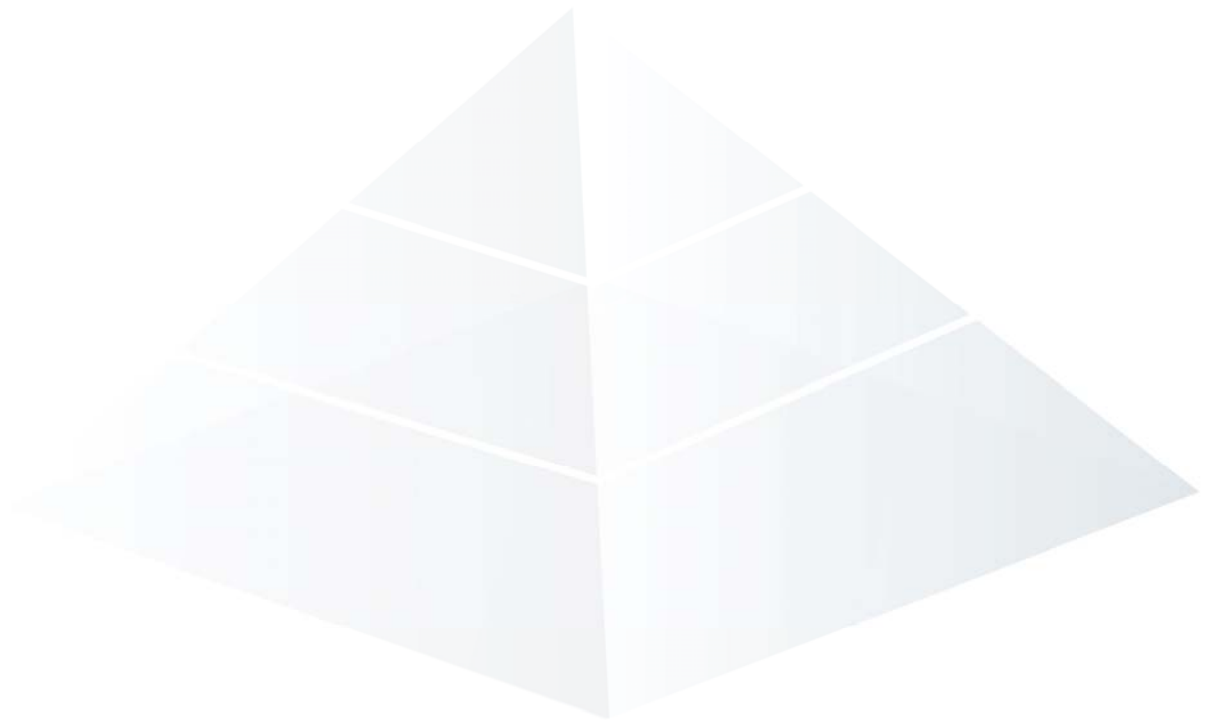
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## HOW MUCH ARE YOUR 401 (K) PARTICIPANTS REALLY PAYING?

Uncovering Revenue for Your Company  
**And Retirement Plan Participants**



**Qualified and Non Qualified Retirement Plans**  
**25+ Years Experience**

## HOW MUCH ARE YOUR 401(K) PARTICIPANTS REALLY PAYING?

**Today plan sponsors are more aware of their fiduciary responsibilities to make well-thought-out decisions than ever before. Historically, administrative fees have not been considered a fiduciary issue because they were typically paid by the plan sponsor. But in today's world of revenue shifting, your participants could be shouldering a heavy burden. Plan sponsors are both required and motivated to know if those fees are reasonable. The problem, providers do not readily offer this information. The solution, an in-depth fee analysis which may save participants dollars and fulfill plan committees' responsibilities.**

### **Why should I be concerned with fees?**

401(k) committees sit in the unique position with fiduciary responsibilities to make decisions in the best interest of participants and simultaneously act as good stewards with corporate assets. Retirement plan fees and expenses meet at the cross roads of these two responsibilities.

Retirement plan fees have historically been divided into two categories: *administrative related* and *investment related*. Administrative fees can be further divided between plan administration fees not caused by employee activity (example: general recordkeeping and trustee fees) and fees associated with employee activity (example: loan and distribution fees). Today, many plan sponsors choose to pay the plan administrative fees and allow the participants to pay the employee activity-related fees. These fees typically have been easy to obtain and compare because they are routinely itemized in billings to the company.

Mutual funds, commingled trust, and money manager expense ratios have historically constituted the primary investment-related fee category. Plan sponsors' reviews of investment funds routinely consider expense ratios and their relation to peer groups. These have also been fairly easy to obtain, but that is becoming more complicated by today's multiple share classes (Exhibit A). At this point, disclosure does not appear to be too difficult, provided plan sponsors research their specific share classes. The real disclosure problems revolve around plan sponsors' unawareness of dollars received by both brokers and providers. These include "finder's fees" and "revenue sharing relationships"

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"Finders fees" refer to one time payments made to brokers by fund companies when transferring retirement plan assets. The fees in many cases can be as high as 1% of the assets. This is significant since most ongoing fees are generally in the range of .25%.

While "finders fees" are becoming more a thing of the past, "revenue sharing" is taking center stage. "Revenue sharing" refers to payments made to providers (commonly referred to as record keepers, third party administrators) by mutual funds or money managers. These payments are in many cases negotiated by the provider, partially based on the size of the provider's business. A large provider with billions of dollars of retirement plan assets can negotiate a larger revenue share from a mutual fund that would like entry into those retirement plan assets. Unfortunately, these revenue sharing arrangements are commonly undisclosed

## Why is disclosure a problem?

**Plan providers are not fiduciaries, plan sponsors are.** Plan providers are not required to act in the participants' best interest, plan sponsors are. Many plan sponsors are forced to make decisions without all of the facts; revenue sharing is only one example.

Plan providers, especially in a bidding situation tend to try to quote their services for zero fees to the plan sponsor. They do this by manipulating investment dynamics, such as share class. Plan sponsors are put in the difficult position of trying to analyze proposals and compare providers using inconsistent fee structures.

**"a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –**

- (A) For the exclusive purpose of**
- (i) Providing benefits to participants and their beneficiaries; and**
- (ii) Defraying reasonable expenses of administering the plan**

*ERISA Section 404 (a)(1)(A)*

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## What are the challenges of fee analysis?

Plan sponsors that embark on the journey to understand plan fees must become familiar with how plan providers price their services and the potential sources of revenue.

(Exhibit A)		American Funds Europacific Growth <sup>(1)</sup>	
Share Class	Ticker	Prospectus Net Expense Ratio	5 Yr Avg. Return*
R1	RERAX	1.72%	7.01%
R5	RERFX	0.59%	8.09%
Difference of:		1.13%	-1.08%

*The higher expense ratio is almost 3 times that of the lower (292%) resulting in a 13% lower net return to investors.*

In this case, the share class decision could cost a participant 13% of the return of the fund.  
\*Past performance is no guarantee of future results.

## Mutual fund share asses

As share classes change, revenue credits to plan providers can be affected. Plan providers can substitute share classes to both increase revenue to the provider and decrease costs to the plan sponsor. But ultimately, those dollars must come from somewhere, often from plan participants' returns.

### Provider fee drivers

Plan sponsors who understand the drivers of plan provider fees can better manage Services, which ultimately impacts fees. If a service is being offered but not used by Participants, the plan sponsor should first consider if the service should continue to Be offered, and second, what the cost (or price) of the service is from the provider. Provider quotes commonly indicate "included" on the proposal or fee quote. It has Been said, "there's no such thing as a free lunch," and it holds true in this case.

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As plan assets increase, the amount of revenue for providers increases as well. The provider may show the plan sponsor a fee schedule based on per head fees, but in reality the provider's revenue is also tied to assets. ***Plan sponsors who do not require providers to disclose all revenue are potentially allowing providers to bill the company and the participants for the same work.*** The water is further clouded by proprietary investments and advisor representatives that are not fiduciaries.

### Proprietary investment vehicles

Proprietary investments, such as the 401 (k) providers' own mutual funds, provide some of the largest revenue sharing arrangements. This is why for many small plans, the provider may require the plan sponsor to use a certain number of proprietary funds in the options. As a fiduciary, the question that should immediately arise is, "is adding proprietary funds in my participants' best interest, or the providers?" Of course, ERISA clearly states that plan fiduciaries must make all decisions "in the best interest of the participants and beneficiaries."

401(k) plans provide an ideal instrument for mutual fund families to add "seed" assets to a newly created fund. With a steady stream of new dollars, the new fund can build a track record for retail investors.

### Who's on my side?

A second factor that creates challenges concerning revenue sharing and ultimately fund selection are provider representatives and brokers who are not fiduciaries with the plan sponsor. The brokers and provider representatives' interest are not necessarily the same as the plan sponsors. Conflicts of interest can arise quickly in these situations. **Plan sponsors are at a natural disadvantage because of the lack of understanding of the retirement plan industry and infrequent changes of their plan providers.**

Certainly a goal of most plan sponsors is to build long-term relationships with vendors, but those relationships also create the need for frequent benchmarking of the provider fees and fee methodology. That, combined with representatives who are not obligated to disclose all revenue, can create fiduciary issues for plan sponsors.

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### Investments, Pricing, Revenue, Where do I go from here?

You've decided to get a better understanding on what participants are paying. You're ready to understand mutual fund share classes, provider revenue sources, and how providers price their services. What comes next?

A successful fee analysis begins with understanding all revenue being received by the provider and its source. Many companies find it helpful to work with an organization that has experience in this area. The plan sponsor can leverage the experience of a third-party organization, which has conducted fee analyses on a regular basis and with multiple providers. Given the complexity of the issues, it is often much easier for plan sponsors to retain an outside firm than take the time to self-educate an entire committee. This is particularly true considering investment-related issues imply the need for investment credentials, education, training, or licenses.

The plan fiduciaries of a national pulp manufacturing company became uneasy with concerns that the plan committee might not be meeting all of their fiduciary requirements, specifically with regard to investment selection and participant costs.

Working with an independent advisor, the company began with a thorough analysis of the current investment options and the revenue being received by the 401(k) provider. The provider's reluctance to provide requested information was only overcome by a letter explaining that the plan sponsor had a fiduciary requirement to understand fees and expenses. The analysis revealed the provider was receiving more than twice the national average per participant due to the share classes, revenue sharing, and proprietary funds being offered. This was surprising to the plan committee because the plan was "free" of administrative fees.

The solution was modifying the fund lineup to include more institutional share class funds and creating a **\$60,000** ERISA budget to pay other qualifying plan expenses, such as consulting, audit, and education fees. The participants acquired an improved and more diversified investment line-up with lower costs, while the plan sponsor gained fiduciary oversight and an ERISA budget at no out-of-pocket expense.

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### Getting the most from your investment – what you should look for in an advisor?

A fee analysis can be a great way to reduce investment expense and provider fees without the burden of a Request for Proposal (RFP). To make the most of this opportunity, companies should carefully choose a qualified independent advisor. Very few plan sponsors can garner the needed leverage to make plan providers show all of their cards and negotiate a better arrangement. What should you look for in an advisor? Here are a few key points.

#### Registered Investment Advisor

A registered investment advisor (RIA) differs from a broker-dealer or wirehouse in one very significant way. RIA's are considered fiduciaries with respect to the advice they provide. Broker-dealers are not. Therefore an RIA must provide advice in the best interest of their clients. Brokers are considered sales agents for the underlying broker-dealer. This is further complicated by the fact that broker-dealers hold themselves out as "retirement plan advisors". First require a contract. Next, read the contract. Look for written acceptance of co-fiduciary status. To make sure you are dealing with an RIA, request an ADV part II. If the advisor does not know what you are asking for, you are probably talking to the wrong advisor.

#### True Independence reduces conflicts of interest

Look for an advisor that is not associated with a plan provider. Plan sponsors are looking for an advocate in their corner, not another sales person looking for a plan with excessive fees. The objective, more times that not, is to improve the relationship that exists, not to go through the pain and discomfort of a provider search, due diligence, and conversion.

“A trustee's lack of familiarity ... is no excuse ... trustees are to be judged according to the standards of others 'acting in a like capacity and familiar with such matters'...The trustees being ill-equipped ... failed to observe their duty to seek outside assistance...”

Katsaros v. Cody 744F2dat 270 (2d Cir. 1984)

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### Experience - Beware the Generalist

A key factor in selecting an advisor to lead a plan sponsor through this process is experience. Look for an organization whose experience lies in the many areas of retirement plan management – administration, investments, and employee education. Many of the best firms are not one or two man shops, but firms with a team approach. Those firms contain a plan design specialist, fiduciary specialist, investment analysts, and service managers, with credentials such as Accredited Investment Fiduciary, Certified Public Accountant, Certified Financial Planner, and Chartered Financial Analyst. Plan sponsors with access to those resources usually stand a greater chance of success. With guidance from independent advisory firms like ours, plan sponsors can feel more confident that the fees they are paying are fully disclosed, appropriately applied, and reasonable in light of the level of services received.

### What's the bottom line?

Unreasonable plan expenses can cost participants thousands of dollars if left unchecked. Plan sponsors not only have a fiduciary obligation to understand these fees but a corporate stewardship obligation as well. With assistance, plan sponsors can take back control of expenses and potentially negotiate better investment vehicles with reduced long term costs. If properly structured, participants in some plans may actually receive investment fees rebated back into their 401 (k) accounts. With potential residual effects such as improved employee moral concerning the 401 (k) plan and reduced fiduciary risk, the time and effort of conducting a fee analysis is well worth the price.