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Roadmap to Understanding Retirement Plan Fees

The only guide you need

Retirement plan fees under the spotlight

You know there are costs associated with offering a retirement plan, but do you understand how much your plan is paying for investments and administrative services? Do you know if any of your plan expenses are being paid through revenue sharing? Are all of the retirement plan fees you are paying reasonable? Have you benchmarked your plan fees against other service providers' fees? Are you in compliance with all of the fee disclosure regulations? Victory Capital's new *Roadmap to Understanding Retirement Plan Fees* can help answer all of these fee questions and more.

These are not easy questions. There has been a dramatic increase in the number of investment options and the types of services available to retirement plans. Yet as a plan fiduciary, under the Employee Retirement Income Security Act of 1974 (ERISA), you are responsible for understanding all of the fees associated with your retirement plan and making sure the fees you pay are reasonable.

In recent years, the Department of Labor's (DOL) increased focus on fee transparency has focused more attention on your responsibility to monitor plan fees. DOL regulations also require that you provide fee information to participants to help them make more informed decisions about their plan and their plan investments.

Fortunately, you don't have to face this challenge alone. Your retirement plan advisor can provide valuable education about plan fees and can help you analyze the expenses related to investments and service options for your plan. In addition, there is a growing library of resources developed by the DOL and the retirement industry regarding plan fees.

To help guide you through the regulatory requirements and practical application of the fee monitoring and disclosure requirements, we have developed the *Roadmap to Understanding Retirement Plan Fees*. Victory's Roadmap provides a framework to help you identify the types of fees that apply to retirement plans and who is responsible for paying these fees. The explanations of the regulations are designed to help deepen your knowledge of your fee-related responsibilities as a plan fiduciary. The piece also serves as a roadmap to additional resources that you may find helpful. Each tool or resource referenced throughout the Roadmap is either included in the Appendix or may be accessed through an Internet link provided in the Appendix. For up-to-date industry studies and litigation summaries, please see the pocket supplement at the back of the resource guide. Our Roadmap also provides key takeaways and action items designed to help you meet your fee-related responsibilities.

This guide is intended to provide accurate and authoritative information in regard to the subject matter covered. It is presented and published with the understanding that the author and publisher are not engaged in rendering legal, tax, investment, or other professional service or advice. If legal, tax, or investment advice or other expert assistance is required, the services of a competent expert should be sought.

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This report is intended for plan sponsors only.

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Most plan sponsors understand that there are costs associated with offering a retirement plan. What they may not realize is just how much their plan is paying, how much they should be paying for plan services and investments, or what options they may have. Plan participants, on the other hand, are often completely unaware that there is a cost associated with participating in their employer's retirement plan.

A Complex Fee Environment

There has been a dramatic increase in the number of investment options and the types of services available to retirement plans. Comparing the costs associated with these options can be a daunting task for a plan sponsor or participant. A recent study by the U. S. Government Accountability Office (GAO)[1] revealed how challenging it can be for plan sponsors to understand and monitor plan fees. The study revealed that sponsors of about 50% of plans did not know if they or their participants paid investment management fees or believed those fees were waived. The majority of plan sponsors had not asked their service providers about investment-related fees, such as 12b-1, sub-transfer agent, or wrap fees. Yet it is a plan sponsor's responsibility to understand plan costs.

The Employee Retirement Income Security Act of 1974 (ERISA), the federal law governing retirement plans, requires that those responsible for managing the plan, referred to as the fiduciaries, must ensure that any services provided to the plan are necessary and that the fees paid for those services are reasonable. In most plans, the plan sponsor is the fiduciary responsible for monitoring fees. The Department of Labor's (DOL) fee transparency rules, described in more depth in Chapters 4 and 5, lists the steps plan sponsors must take to ensure that only reasonable fees are paid by the plan.

"I thought my retirement plan was free!"

Retirement plans have never been "free." Most investments charge fees, whether purchased through a retirement plan or in another type of investment account. In addition, most retirement plans engage service providers to ensure the plan operates properly and qualifies for federal tax benefits. These services are not free, and, in most plans, participants pay a portion of these fees.

Fiduciaries who fail to satisfy their responsibilities regarding fee oversight may be subject to DOL enforcement action. In recent years, with the expanded fee disclosure requirements issued by the DOL, the focus on plan fee oversight has become increasingly intense. In addition to DOL scrutiny of plan fees, plan fees have been the subject of lawsuits by retirement plan participants against plan fiduciaries. The focus of these suits has been whether participants' retirement benefits were eroded as a result of insufficient oversight by the plan fiduciaries, regarding whether the fees charged against participants' accounts was a breach of the fiduciary's duties of prudence and loyalty.

An important first step in overseeing plan fees is, of course, understanding all of the components that make up total plan costs – what services are provided, how plan fees are structured, who pays what, and to whom.

[1] 401(k) Plans: Increased Educational Outreach and Broader Oversight May Help Reduce Plan Fees – www.gao.gov/products/GAO-12-325

Defined Contribution Plan Costs

Investment Fees	Plan Administration Expenses	Investment Consulting/ Plan Advice Expenses
Investment Management Administration Account Maintenance Distribution Charges Sales Charges	Data and Transaction Processing Recordkeeping Compliance Testing Plan Documents and Amendments Participant Statements Plan Reporting	Performance Monitoring Due Diligence, Hiring, and Monitoring of Funds and Investment Managers Investment Policy Statement Preparation Fund and Investment Manager Fee Negotiation

Overview of Plan Costs

Defined contribution (DC) plan costs can be broken down into three major categories: investment product fees, plan administration expenses, and investment consulting or advice expenses.

Under each of these cost categories, there are a variety of possible fee structures, compensation models, and service arrangements. These cost structures can be complex and — before the DOL's fee disclosure regulations — were not always apparent to a plan sponsor.

Retirement Plan Advisors Add Value

Investment guidance or advice is a valuable plan service provided by retirement plan advisors. Advisors are an excellent source of education and information regarding plan fees. In addition to helping a plan sponsor compare the features and fees associated with the various investment options, an advisor can help a plan sponsor document the due diligence process the plan sponsor followed to satisfy its fiduciary obligation in selecting the investments and ensuring the fees are reasonable.

Effective investment consulting should result in:

- The creation of a custom Investment Policy Statement for the plan
- The selection of prudent investment choices
- A menu of investment options that meet the criteria outlined in the plan's investment policy
- Fee and revenue sharing arrangements that are reasonable from a fiduciary perspective
- Regular fee benchmarking to comply with fiduciary responsibility

There are a variety of compensation structures that may apply to the services of financial advisors and retirement plan consultants, depending in part upon whether they are serving as a fiduciary or providing guidance as a non-fiduciary. Plan sponsors should be careful to examine the advisor relationship for potential conflicts of interest. Ask questions: How is my financial advisor being paid? Are there financial incentives in the arrangement that could affect my retirement plan advisor's recommendations? Does my advisor receive a different level of compensation based on the actual investments selected?

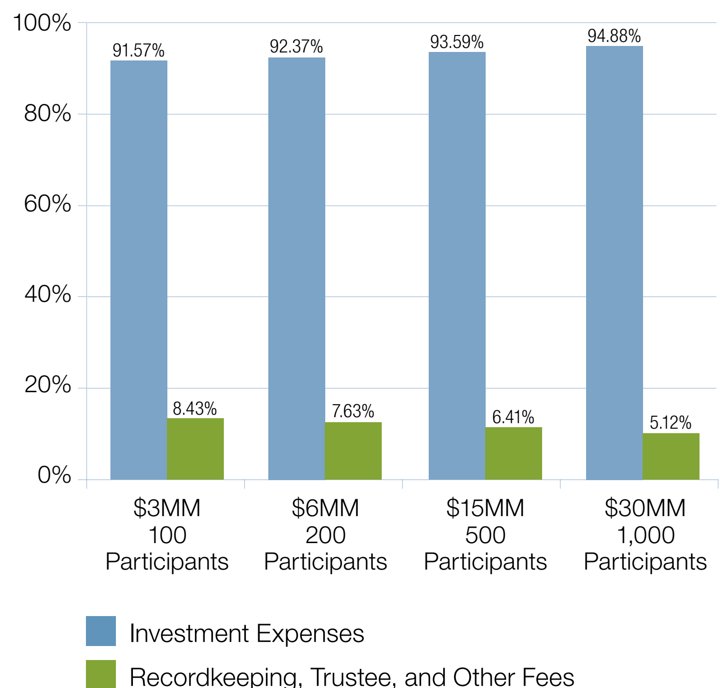
Investment Fees

While every cost matters, investment fees comprise the majority of plan expenses. Usually charged as a fixed percentage of assets and deducted from investment returns, investment fees are typically borne by participants because they reduce the overall return of each plan investment.

Plan sponsors today can choose from a wide range of investment strategies, vehicles, and providers, all with varying fee structures. Coupled with the fact that participants pay most of the investment fees, the job of selecting and monitoring plan investment options is one of the most critical fiduciary responsibilities for plan sponsors. While plan sponsors rely on the expertise of their advisors to guide them in understanding and evaluating various options to include in the plan's investment lineup, it is important for plan sponsors to have a basic understanding of the most common types of retirement plan investments and their related fee structures.

Investment Fees Drive 401(k) Plan Costs

Percentage Cost by Plan Size
($30,000 Average Account Balance)



Source: *Data licensed from 401k Averages Book, 13th Edition*

Mutual Funds: The Dominant Player

Mutual funds are the most common investment vehicle used by defined contribution plans. Mutual funds pool and invest the money of many investors. Each investor owns shares that represent a part of the mutual fund's holdings. The mutual fund is invested in stocks, bonds, and other assets and is managed by a professional investment adviser.

The cost of operating a fund is referred to as the "total annual operating expense" or "expense ratio." These costs reduce the overall return (the average annual total return) of the fund. Mutual fund fees are disclosed to plan sponsors and plan participants through the fund's prospectus and cover services related to:

- Portfolio management
- Fund administration
- Accounting and pricing
- Shareholder servicing
- Distribution and marketing of the funds (12b-1 fees)
- Sales (e.g., front-end and back-end loads, deferred sales charges, or redemption fees)

Mutual fund fees vary not only from one mutual fund to the next, but also among share classes within the same fund. Mutual fund companies may provide a multi-class share structure to allow for different advisory and shareholder services that may be desired by different types of investors in the same fund. For defined contribution plans, the most common share classes are R, A, and I, each tailored to the requirements of different defined contribution plan sizes. Generally there is a minimum investment requirement for I class shares that effectively limits that class to large plans. Because A and some R shares typically carry distribution (12b-1) and sub-T/A fees to fund the servicing needs of small- and mid-size plans, operating expenses tend to be higher than for the I share class used in large plans. An advisor can guide a plan sponsor in analyzing the most appropriate share class for their plan's investment lineup.

Annual Impact of Fees for Different Mutual Fund Share Classes

Hypothetical Example – Large Cap Funds

Share Class	Portfolio Management Fee	Distribution (12b-1) Fee	Other Expenses		Total Expense Ratio
			Sub T/A Fee Administrative Services	Other	
I	0.50%	0.00%	0.00%	0.20%	**0.70%**
A	0.50%	0.25%	0.25%	0.20%	**1.20%**
R	0.50%	0.50%	0.25%	0.20%	**1.45%**
C	0.50%	1.00%	0.50%	0.20%	**2.20%**

Target Date Funds: Designed for Specific Retirement Dates

Target Date Funds (TDFs), sometimes called lifecycle funds, have become a popular investment option for 401(k) plans and other plans that allow plan participants to direct their investments. TDFs are intended to be long-term investments for investors with a specific retirement date in mind. The name of the fund often includes the target date, such as "Target 2040" or "Retirement Fund 2040." These funds automatically adjust the investment mix of the fund to become more conservative as the target retirement date approaches, which makes them attractive to employees who do not want to manage the investment of their retirement savings account. TDFs may be mutual funds or hold a mix of investments including mutual funds. Each TDF may have a different investment strategy even if they have the same target retirement date. For example, two TDFs labeled as "2040" may differ significantly in the level of equities held at various points of time.

Fees charged for TDFs will vary too, and may include:

- Sales fees
- TDF administration fees
- Fees associated with the underlying funds included in the TDF

Because the investment strategy and associated fees for each TDF varies, benchmarking TDF performance and fees can be complex. To aid plan sponsors in understanding how to fulfill their fiduciary duties of prudence and due diligence in selecting TDFs for their plans, the DOL released a "tip sheet," *Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries*. This tip sheet provides an overview of TDFs and explains the key items that plan sponsors should consider as they select and monitor these funds. A link to the DOL's tip sheet is included in the Appendix.

Model Portfolios: A Customized Option

For participants who want assistance with selecting investments from the available options in their retirement plan, some plan advisors offer custom model portfolio services. A custom model portfolio is a pre-selected mix of the retirement plan's investment options that would be appropriate for certain investor characteristics such as risk tolerance or age. Custom model portfolios can be an alternative to TDFs for participants who want an asset allocation more specific to their risk tolerance objectives (e.g., conservative, moderate, or aggressive) or who do not want to tie their investment strategy to a retirement date. Custom model portfolios can be a helpful option to participants who do not want to select their own investment mix from the plan's lineup of investments.

Collective Trust Funds: A Mutual Fund Alternative

A Collective Trust Fund (CTF) is a tax-exempt, pooled investment vehicle administered by a bank or trust company and is available to both defined contribution and defined benefit retirement plans. CTFs are regulated by the Office of the Comptroller of the Currency (OCC), which oversees banks and trust companies, rather than being registered with the Securities and Exchange Commission like mutual funds. A CTF that consists solely of funds of retirement, pensions, profit sharing, stock bonus, and other trusts that are exempt from federal income tax is sometimes referred to as an "A2 fund," referring to the section of the OCC rules that define them. CTFs offer a full assortment of equity and fixed income asset classes and styles and are available on many defined contribution plan platforms.

CTFs are different from mutual funds because they:

- Are designed specifically for qualified plans, so they do not bear the expenses associated with servicing large numbers of retail clients.
- Do not charge front- or back-end fees.
- Are exempt from registration with the Securities and Exchange Commission, so may avoid certain costs associated with registration, board meetings, and preparing and distributing proxies, prospectuses, and Statements of Additional Information.
- Feature flexible pricing structures.

CTFs may be better suited for large rather than small plans because their flexible pricing structures allow for lower pricing to plan sponsors with more assets under management.

Variable Annuities: Combining Insurance Features and Investments

Annuity investment products offered by insurance companies are widely used in retirement plans, with plan assets frequently packaged on a group annuity platform. A group variable annuity contract wraps around the plan's investment options, which can include investment options and separate account portfolios, and fees are wrapped into an overall charge. The participant has a pooled investment account with a contract that has insurance-related elements and charges, including those for an annuity feature, interest and expense guarantees, and any death benefit provided during the contract term.

Investment fees for annuities are disclosed to plan sponsors and plan participants in the annuity contract. Fees and expenses are assessed at two levels. The first is for investment management, similar to the fees paid by participants in non-annuity programs. The second set of "wrap" fees may include:

- Charges for investment consulting and commissions
- Insurance-related charges, such as sales expenses, mortality risk charges, and the cost of issuing and administering contracts
- Surrender and transfer fees
- Recordkeeping fees

Self-Directed Brokerage Accounts

In addition to selecting a lineup of investment options, some plans allow participants to open a self-directed brokerage account within the plan. This option, sometimes referred to as a "brokerage window," gives participants access to investment choices beyond those designated by the plan, such as individual stocks. Participants who are more experienced investors, or who have engaged an investment advisor or investment manager to design an investment strategy for their plan assets may be interested in a brokerage account.

The plan sponsor must select the service provider to deliver these brokerage account services. Under the DOL's fee transparency rules, the plan sponsor must provide annual disclosures explaining this investment option and how it works, and a general statement that fees may be charged against a participant's individual account if the participant uses the brokerage window. The plan sponsor must also tell participants where they can obtain information about such fees and must disclose, quarterly, any fees actually charged against a participant's account in connection with brokerage window transactions, including front-end sales loads and trading commissions.

Plan Administration Fees

Plan administration expenses are assessed for the day-to-day operational support needed to run the plan efficiently and in compliance with the rules that apply to retirement plans. Plan administration fees are disclosed to the plan sponsor through service agreements and required service provider fee disclosures.

General Administration Fees

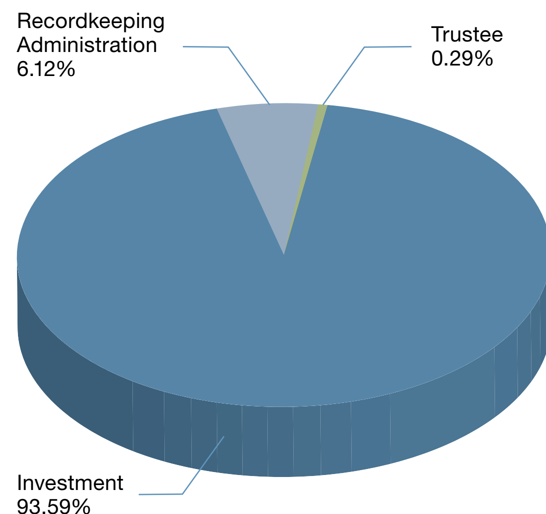
Most plan sponsors hire companies to provide record-keeping and third-party administrator services to help operate the plan properly. The recordkeeping and third-party administration services are sometimes delivered by the same service providers.

Recordkeeping fees typically cover the following costs:

- Data and transaction processing
- Processing and tracking investment elections
- Operating a web site or a call center for participants to change investment elections or request transactions or plan information

Percentage Breakdown of Plan Costs

($15MM Assets, 500 Participants, $30,000 Average Account Balance)



Source: *Data licensed from 401k Averages Book, 13th Edition*

Third-party administration fees typically cover services such as:

- Creating plan documents
- Performing compliance testing
- Generating plan reporting
- Producing and delivering participant statements
- Administering distributions and loans
- Calculating eligibility, vesting, and contributions

Plan sponsors may incur additional fees for administrative services provided to the plan, such as:

- Legal or accounting services
- Trustee services
- Investment consulting/plan advice services
- Certain participant communications and educational services

General plan administration and additional plan services fees are usually assessed as a quarterly or annual flat fee, a per-participant fee, or some combination of these two fee structures. Fees may also be calculated based on a percentage of plan assets. Plan administration fees may be paid directly by the plan sponsor or from plan assets. If paid from plan assets, these fees are often allocated to the participants on a pro rata basis (proportionate to the participant's account balance) or on a per capita basis (dividing the expense equally among participants). Plan forfeiture accounts may also be used to pay these expenses.

Individual Transaction and Service Fees

Some fees are incurred not by the plan as whole, but as the cost of processing a transaction or optional plan feature for an individual participant. Participant transaction fees could be charged to a participant for:

- Taking a hardship distribution or a loan.
- Using participant investment advice services.
- Submitting a qualified domestic relations order.
- Accessing a brokerage window.

Transaction fees are typically expressed as a flat dollar amount and are usually charged to the affected participant's account.

Settlor Functions

Certain services are viewed by the DOL as primarily benefiting the plan sponsor, rather than the plan participants, and cannot be paid from plan assets. These services, referred to as "settlor functions," include services related to formation of the plan, such as tax consultation and plan design decisions, as opposed to services related to plan management and administration. They also include costs related to correcting compliance or fiduciary errors and penalties for late filings. Fees for settlor functions must be paid by the plan sponsor.

Who Pays Plan Fees?

Expense	Definition	Source of Payment
Investment Expenses	• Total annual operating expenses • Sales charges	Generally paid by plan participants (e.g., annual operating expenses are deducted from investment returns, sales charges are assessed at time of purchase or redemption)
Plan Administration & Other Expenses (Non-Settlor Expenses)	• Administrative and recordkeeping fees • Transaction fees • Education and advice service fees • Costs for IRS-mandated plan amendments	Paid by plan sponsor or from plan assets
Settlor Expenses	• Legal and accounting fees related to plan sponsor's decision to establish or terminate a plan • Plan design studies • Plan amendment costs (other than mandated amendments) • Union negotiations • Cost of correcting compliance and fiduciary errors • Penalties for late filings	Paid by plan sponsor – cannot be paid from plan assets

To Bundle or Unbundle? That is the Question

Some service providers offer "bundled" arrangements in which a single provider or group of providers package certain services together (e.g., investments, recordkeeping, education) for a stated fee. In unbundled structures, the plan sponsor can select separate service providers for the various functions.

In bundled arrangements, it was often difficult for a plan sponsor to understand how much they were paying for each service included in the bundled arrangement. This made it difficult for plan sponsors to fulfill their fiduciary responsibility to ensure the fees were reasonable. Now, under the DOL fee transparency rules, the recordkeeping fees must be segregated and separately disclosed.

The range and types of services available for retirement plans can vary widely in both bundled and unbundled structures. It is the plan sponsor's fiduciary responsibility to understand whether the services are needed, and to understand how much is being charged for the services to ensure plan fees are reasonable.

Revenue Sharing

Revenue sharing generally refers to payments by an investment provider, such as a mutual fund company or insurance company, to other plan service providers for product distribution or recordkeeping/administrative services.

Distribution (12b-1) fees are paid by mutual funds to cover costs related to marketing and distributing fund shares, such as compensating advisors for selling fund shares and covering the costs of advertising and delivery of prospectuses to new shareholders. 12b-1 fees collected from the fund assets may also be used to pay other service providers for certain shareholder services.

Sub-transfer agency (sub-T/A) fees reimburse service providers for services that would otherwise need to be performed by the investment provider, such as tracking how many shares an individual holds, tracking all the buys and sells of that individual, and mailing prospectuses. When the investor is a participant in a retirement plan, the investment provider may not have to provide all of these services because the participant-level tracking is typically done by the plan's recordkeeper or other service providers.

Revenue sharing payments are typically calculated as a percentage of assets or a flat dollar amount per participant. A single mutual fund may have multiple share classes with different levels of advisory and shareholder services, resulting in different expense ratios and different revenue sharing for the various share classes.

If revenue sharing is a part of the fee structure, plan sponsors have an obligation to understand how the revenue sharing works in order to make a prudent decision regarding the reasonableness of fees relative to the services provided. For example, if the recordkeeper is receiving sub-T/A fees, the plan sponsor should determine whether the recordkeeper is using that amount to offset or reduce the plan administration expenses the plan would otherwise need to pay. Whether it is beneficial to select a fund with significant revenue sharing payments that will be used to reduce administrative costs, or select funds or a share class within a fund that has lower expenses, must be determined by the plan sponsor on a case-by-case basis.

Administering Revenue Sharing

Two common approaches to administering revenue sharing related to plan administration services are to (1) have the recordkeeper retain the revenue sharing and apply "credits" to offset the expense of plan administration and pay for additional services at the plan sponsor's direction, or (2) deposit revenue sharing into a separate account within the plan trust (sometimes referred to as an ERISA fee recapture account, ERISA budget account, or ERISA account). ERISA fee recapture accounts are designed to help make revenue-sharing arrangements more transparent to plan sponsors, enabling them to track and control which services are purchased using the ERISA account. The ERISA fee recapture account can also be used to hold any excess revenue sharing that is received beyond the agreed-upon recordkeeping fee.

Your retirement plan advisor can help you understand the fees associated with your investment selections and your recordkeeping services, as well as how special fee arrangements, like revenue sharing, can affect your plan's fees.

Investment Policy Statement

Typically drafted with the help of a retirement plan advisor, an Investment Policy Statement (IPS) is an important tool that plan sponsors can use to guide their investment product research and decisions. An IPS is a written policy that defines the criteria for selecting and monitoring investment options for the plan. The IPS helps guide the plan sponsor and/or the plan's investment committee through an established process to make investment decisions for the plan, including analysis of the fees related to various investments. The IPS provides a consistent set of actions to follow in periodic investment reviews. A plan sponsor's retirement plan advisor can provide a sample IPS.

An IPS should be reviewed at least annually and updated as needed to adapt to changes in plan demographics as well as economic and financial industry developments. An IPS will typically include the following elements:

- Plan fiduciary's criteria for selecting and monitoring investments (e.g., performance criteria, benchmarks)
- Timing for investment performance reviews (e.g., monthly, quarterly)
- Rationale for deciding when to replace investments

If a plan sponsor adopts an IPS, it is critical that they follow the guidelines established in the IPS. In some lawsuits, the plaintiffs have claimed that a fiduciary's failure to follow established policies is a breach of fiduciary responsibility. If an investment committee is used to monitor investments, a meeting calendar should be set with specific agenda items that align with the IPS.

Key Takeaways and Action Items

Understand the types of fees charged to your plan.

Review the information provided by your service providers, and engage your retirement plan advisor to create an inventory of plan expenses.

Your retirement plan advisor is an excellent source of education and information regarding plan fees. Your advisor can help you understand the fees associated with various investment options and with plan administration services such as recordkeeping and third-party administration services. Advisors can explain how special fee arrangements, like revenue sharing, can affect your plan's fees.

Identify revenue sharing or other special fee arrangements that apply to your plan.

Fee arrangements such as revenue sharing, ERISA fee recapture accounts, and fee off-setting can be complex. As a plan fiduciary responsible for paying only reasonable plan fees, you must fully understand your plan's fee arrangements and have a working knowledge of the underlying details. Review the fee disclosures provided by your service providers under the DOL fee transparency rules and discuss revenue sharing relationships with your service providers.

Your plan advisor is also a resource to help you understand fee arrangements. If you find that your plan's service arrangements and fees need improvement, your advisor can be instrumental in implementing changes, including renegotiating arrangements with investment managers, vendors, and service providers.

Consider adopting an Investment Policy Statement (IPS).

An IPS can help plan sponsors maintain consistency in investment selection and monitoring criteria. If you already have an IPS, review it to ensure it is aligned with your current plan objectives and employee demographics. Take the time to review your current investment practices to ensure you are following your IPS.

To illustrate the mutual fund revenue sharing concepts we covered in Chapter 1, the following two case studies show how fees and expenses flow in hypothetical plan investment lineups. Case study #1 illustrates how certain mutual fund revenue that is shared with a recordkeeper can be used to pay a portion of the plan administration costs. Case Study #2 analyzes the impact on overall plan fees when lower-cost mutual fund shares (I Shares) that do not produce revenue sharing are selected by the plan.

CASE STUDY #1 – A SHARES

Plan Objective: Minimize amount paid out-of-pocket or from plan assets for administrative costs

Total Plan Assets:	$10,000,000
Participants:	350
Recordkeeping Fee:	$12,500
Third Party Administrator Fee:	$10,500
Investment Lineup:	Predominantly Mutual Fund A Share Classes
Advisor Compensation:	Commission-based payment from mutual fund 12b-1 fees

Part 1 – Analyzing the Plan Investment Lineup for XYZ Client

As you review the following fund lineup for the sample plan, there are a few things to keep in mind.

- There are a different number of participants invested in each fund, which affects the revenue credit that is generated.
- The "Expense Ratio" and "Fund Expense" differ for each fund, but all funds have some expenses.
- The columns shaded in blue represent the allocation of the fee credits, not additional fees.
- This example only illustrates the advisor compensation received from 12b-1 fees. The advisor may receive other compensation from the plan sponsor or the plan for providing additional services such as participant education.
- This example reflects a Third Party Administrator (TPA) fee of $30 per participant ($30 x 350 participants = $10,500).

XYZ Plan Expenses and Estimated Fee Credit Analysis – (Hypothetical Example)

Predominantly A Class Shares

Fund Name	Plan Assets in Fund	Plan Participants	Expense Ratio	Fund Expense	12b-1 Fee	Administrative Services	Sub-TA Fee Credits	Total Revenue Credit
Large Cap Growth Fund	$1,000,000	175	0.0133	$13,300	0.0025	0.002	$ 875	**$ 5,375**
Large Cap Core Fund	$2,000,000	200	0.0109	$21,800	0.0025	0.002	$1,000	**$10,000**
Large Cap Value Fund	$1,750,000	175	0.0123	$21,525	0.0025	0.002	$ 875	**$ 8,750**
Mid Cap Growth Fund	$ 250,000	125	0.0162	$ 4,050	0.0025	0.002	$ 625	**$ 1,750**
Mid Cap Core Fund	$ 350,000	150	0.0144	$ 5,040	0.0025	0.002	$ 750	**$ 2,325**
Mid Cap Value Fund	$ 312,000	100	0.0135	$ 4,212	0.0025	0.002	$ 500	**$ 1,904**
Small Cap Value ABC Fund	$ 700,000	150	0.0140	$ 9,800	0.0025	0.002	$ 750	**$ 3,900**
International Large Cap Fund	$ 650,000	125	0.0150	$ 9,750	0.0025	0.002	$ 625	**$ 3,550**
Intermediate Bond Fund	$ 530,000	250	0.0094	$ 4,982	0.0015	0.002	$1,250	**$ 3,105**
Stable Value Fund	$1,788,000	120	0.0075	$13,410	0	0.002	$ 600	**$ 2,388**
Target Date Fund 2020	$ 70,000	15	0.0114	$ 798	0.0025	0.002	$ 75	**$ 390**
Target Date Fund 2030	$ 150,000	25	0.0118	$ 1,770	0.0025	0.002	$ 125	**$ 800**
Target Date Fund 2040	$ 300,000	25	0.0120	$ 3,600	0.0025	0.002	$ 125	**$ 1,475**
Target Date Fund 2050	$ 150,000	5	0.0122	$ 1,830	0.0025	0.002	$ 25	**$ 700**
	$10,000,000			**$115,867**	**$20,000**	**$18,212**	**$8,200**	**$46,412**

XYZ Plan Expense Worksheet

Total Annual Recordkeeping Fee	$ 12,500
Third Party Administrator Fee ($30 per participant)	$ 10,500
Annual Advisor Fee (flat dollar amount)	$ 0
Annual Advisor Fee (asset-based 12b-1 fee)	$ 20,000
Total Annual Recordkeeping, TPA & Advisor Fees	$ 43,000
Less: Total Revenue Credit	$ 46,412
Annual Net Plan Credit	**$ 3,412**

Part 2 – Dissecting One Fund's Expenses

The expenses of each mutual fund can differ, as shown in the table in Part 1. Following is a hypothetical breakdown of the investment management fees and revenue sharing credits for the Small Cap ABC Fund.

Fund Name	Fund Balance	Plan Participants	Expense Ratio	Fund Expense	12b-1 Fee	Administrative Services	Sub-TA Fee Credits	Total Revenue Credit
Small Cap ABC Fund	$700,000	150	0.0140	$ 9,800	.0025	.0020	$750	**$3,900**

The prospectus for Small Cap ABC Fund identifies three categories of fees that make up the expense ratio: management fees, distribution (12b-1) fees, and other fees. The chart below illustrates how these fees are calculated and distributed.

Management Fee (0.80%) +		**Distribution (12b-1) Fees (0.25%) +**	**Other Fees (0.35%) = 1.40%**	
$700,000 x 0.80% = $5,600		$700,000 x 0.25% = $1,750	$700,000 x 0.35% = $2,450	
0.60% retained by Small Cap ABC Fund for investment manager	0.20% paid to recordkeeper for administrative services	0.25% paid to dealer of record for sales and marketing	$5 per participant paid to recordkeeper (Sub-T/A Fees)	Remainder retained by Small Cap ABC Fund
$700,000 x 0.60% = $4,200	$700,000 x 0.20% = $1,400	$1,750	$5 x 150 participants = $750	$2,450 - $750 = $1,700
Total Small Cap ABC Fund Expenses Paid by Plan Participants = $9,800 (1.40% of $700,000) Amount Retained by Small Cap ABC Fund = $5,900 ($4,200 + $1,700) Total Revenue Credit = $3,900 ($9,800 - $5,900)				

Part 3 – Understanding the Revenue Credit

In this example, Small Cap ABC Fund retains $5,900 in revenue ($4,200 management fee + $1,700 in other fees) and the remaining $3,900 represents the Total Revenue Credit. The dealer of record is paid $1,750 (12b-1 fees) and uses a portion of those fees to pay the advisor. The remaining revenue of $2,150 ($1,400 + $750) represents administrative fees and sub-T/A fees that will be used to pay the recordkeeper. The $2,150 revenue sharing amount received by the recordkeeper may be retained by the recordkeeper and applied as a revenue "credit" to offset the recordkeeping expenses. Alternatively, a recordkeeper may deposit the revenue-sharing credit in a separate account within the plan trust, sometimes referred to as an ERISA fee recapture account or ERISA budget account. The account is used to pay plan administration expenses or fees for other plan services, such as participant education.

In a perfect world, the revenue credit should be about equal to the plan operating costs. If there are extra revenue credits the plan sponsor may want to consider finding a share class of funds with lower expenses or revenue, as demonstrated in Case Study #2.

Case Study #2 – I SHARES

While the XYZ investment strategy described in Case Study #1 (in which revenue sharing is used to offset a portion of plan administration expenses) is fairly common, there will be variations in expense and compensation structures depending on the investments selected and the share class. Case Study #2 illustrates how the investment and plan fees are affected by using a mutual fund share class that does not pay 12b-1 fees.

Plan Objective: Provide lowest investment cost option, with plan sponsor or plan assets paying for expenses not absorbed by revenue credits.

Total Plan Assets:	$10,000,000
Participants:	350
Recordkeeping Fee:	$12,500
Third Party Administrator Fee:	$10,500
Investment Lineup:	Predominantly Mutual Fund I Share Classes
Advisor Compensation:	Fee of $20,000

Analyzing the Plan Investment Lineup for XYZ Client

As you review the following fund lineup for Case Study #2, there are a few changes to keep in mind from Case Study #1.

- Institutional (I) share class mutual funds that do not charge 12b-1 fees are used instead of A share class mutual funds.
- The retirement plan advisor charges a flat fee of $20,000 for plan services.
- This example reflects a Third Party Administrator (TPA) fee of $30 per participant ($30 x 350 participants = $10,500).

XYZ Plan Expenses and Estimated Fee Credit Analysis – (Hypothetical Example)

Predominantly I Class Shares

Fund Name	Plan Assets in Fund	Plan Participants	Expense Ratio	Fund Expense	12b-1 Fee	Administrative Services	Sub-TA Fee Credits	Total Revenue Credit
Large Cap Growth Fund	$ 1,000,000	175	0.0098	$ 9,800	0	0.001	$ 0	**$ 1,000**
Large Cap Core Fund	$ 2,000,000	200	0.0082	$ 16,400	0	0.001	$ 0	**$ 2,000**
Large Cap Value Fund	$ 1,750,000	175	0.0086	$ 15,050	0	0.001	$ 0	**$ 1,750**
Mid Cap Growth Fund	$ 250,000	125	0.0120	$ 3,000	0	0.001	$ 0	**$ 250**
Mid Cap Core Fund	$ 350,000	150	0.0100	$ 3,500	0	0.001	$ 0	**$ 350**
Mid Cap Value Fund	$ 312,000	100	0.0098	$ 3,058	0	0.001	$ 0	**$ 312**
Small Cap Value ABC Fund	$ 700,000	150	0.0106	$ 7,420	0	0.001	$ 0	**$ 700**
International Large Cap Fund	$ 650,000	125	0.0110	$ 7,150	0	0.001	$ 0	**$ 650**
Intermediate Bond Fund	$ 530,000	250	0.0062	$ 3,286	0	0.001	$ 0	**$ 530**
Stable Value Fund	$ 1,788,000	120	0.0050	$ 8,940	0	0.001	$ 0	**$ 1,788**
Target Date Fund 2020	$ 70,000	15	0.0076	$ 532	0	0.001	$ 0	**$ 70**
Target Date Fund 2030	$ 150,000	25	0.0080	$ 1,200	0	0.001	$ 0	**$ 150**
Target Date Fund 2040	$ 300,000	25	0.0083	$ 2,490	0	0.0012	$ 0	**$ 300**
Target Date Fund 2050	$ 150,000	5	0.0083	$ 1,245	0	0.001	$ 0	**$ 150**
	$10,000,000			**$ 83,071**	**0**	**$10,000**	**$ 0**	**$10,000**

XYZ Plan Expense Worksheet

Total Annual Recordkeeping Fee	$ 12,500
Third Party Administrator Fee ($30 per participant)	$ 10,500
Annual Advisor Fee (flat dollar amount)	$ 20,000
Annual Advisor Fee (asset-based 12b-1 fee)	$ 0
Total Annual Recordkeeping, TPA & Advisor Fees	$ 43,000
Less: Total Revenue Credit	($ 10,000)
Annual Net Plan Debit	**($33,000)**

Note: I share class may not be available for all investment styles and may have a minimum investment requirement

Comparing the Options

In Case Study #1, plan revenue from the A share class mutual funds produced a total credit that paid plan costs – advisor commissions, administrative expenses, and Third Party Administrator Fees. There were no out-of-pocket expenses for the plan sponsor or debits from participants' plan balances, and there was a $3,412 credit left over.

In Case Study #2, the investment expenses were lower because the plan used I share class funds with no 12b-1 fees. The advisor was paid a flat fee of $20,000 for support services, rather than being paid through the 12b-1 fees. The revenue credit in Case Study #2 did not offset all recordkeeping, advisor fees, and Third Party Administrator Fees. As a result, the shortfall must be paid by the plan sponsor or paid with plan assets – or a combination of the two.

The "right" choice of investment share classes and expenses depends on the plan's fee objectives and investment policy, and must take into consideration the combination of investment fees and plan fees relative to the services provided.

A wide range of fee arrangements and compensation agreements are available to plan sponsors. As shown in the two case studies, the right choice for your plan depends on your objectives. Most plan sponsors rely on the expertise of their retirement plan advisors to help them compare these complex fee and revenue-sharing arrangements, including analyzing the impact of using different class shares.

Objective	Plan Sponsor Preference	Participants Pay through Mutual Fund Revenue Sharing	Paid By Plan Sponsor (or Plan Assets)
Minimize amount paid out-of-pocket or from plan assets for recordkeeping costs	Case Study #1 – predominantly A share class funds with revenue sharing	$46,412	0
Provide lowest investment cost option with plan sponsor or plan assets paying for expenses not absorbed by revenue credits	Case Study #2 – predominantly I share class funds with low investment costs	$10,000	$33,000

3 Heightened Focus on Fees and Fee Disclosure: Who Does What?

Retirement plans have never been free, so why in recent years is there so much discussion about plan fees? The reason stems from the interplay of a number of important changes in the retirement industry.

Increase in Variety and Complexity of Compensation Models

It sometimes feels like it takes a large team to support a retirement plan – advisors, administrators, trustees, and other service providers. Each service provider must be paid for their services. As the industry has evolved, service providers sometimes delegate or share some of their responsibilities with other parties, including sharing the revenue associated with that service. In its FAQs, titled *Disclosures to Help Employees Understand Their Retirement Plan Fees*, the Department of Labor (DOL) acknowledged that many of these changes have improved efficiency and reduced the cost of administrative services and benefits for plans and plan participants. However, this increasing complexity in the financial industry makes it hard for plan fiduciaries and participants to understand how much they are paying for plan services and to whom.

Shift in Investment Responsibility to Plan Participants

The shift from defined benefit plans to defined contribution plans, such as 401(k) plans, as the dominant retirement savings vehicle has increased the responsibilities of the plan participant regarding how they save for retirement. Most defined contribution plans allow the plan participant to select plan investments. Yet, many of these participants are ill-equipped to understand the fee structure of the investments they are considering for their retirement savings or the fees they are paying for plan administration service and other transactions.

Increased Regulatory Focus on Fees

The industry factors described above and industry surveys of plan sponsors and participants, which have revealed the challenges they face in understanding fees, put this issue in the DOL's focus for regulatory oversight. The DOL launched a fee transparency initiative to expand fee disclosure requirements and to develop educational information and other resources to help plan sponsors and participants understand retirement plan fees.

DOL Fee Transparency Initiative

Disclosure Requirements

The DOL launched a three-part approach to fee transparency beginning in 2008. Part 1 requires retirement plan service providers to deliver fee disclosures to plan sponsors. Part 2 mandates plan sponsor disclosures to participants and beneficiaries, and Part 3 requires the reporting of plan fees to the IRS and DOL via the Form 5500, Annual Return/Report of Employee Benefit Plan, filed by plan sponsors. Let's look at each of these initiatives and how the disclosures affect plan sponsors.

The first part of the fee transparency initiative requires service providers to disclose fees to plan sponsors. The regulations under ERISA Section 408(b)(2) are designed to ensure that each plan fiduciary receives the information they need to assess the reasonableness of service provider fees and identify potential conflicts of interest before entering into a service relationship. These regulations are discussed in more depth in Chapter 4.

The ERISA 404a-5 participant fee disclosure regulations, the second part of the DOL's initiative, are designed to ensure plan participants have the information they need to make informed decisions about the management of their accounts and the investment of their retirement savings. The plan sponsor, assuming they are serving as the ERISA plan administrator, is responsible for providing the participant disclosure, typically with the assistance of their recordkeeper or other service provider. The participant-level fee disclosures apply to participant-directed individual account defined contribution plans such as 401(k) plans and ERISA 403(b) arrangements. These participant-level fee disclosures rules are discussed in more depth in Chapter 5.

The third part of the DOL's disclosure initiative expanded the direct and indirect fee information that must be reported on Schedule C of the Form 5500. Schedule C is only required for plans with 100 or more participants. Besides providing fee information to the DOL, the mandated fee reporting in Schedule C is designed to help plan sponsors gather data on and analyze the fees actually paid for plan services.

DOL Education Campaign

In addition to mandating fee disclosure, the DOL has engaged in a robust fee education effort. The DOL has developed a variety of educational resources and tools to help plan sponsors and plan participants make more informed retirement plan decisions.

The DOL has devoted an entire website to helping participants locate DOL fee information. The website includes links to:

- Webcasts
- Videos
- Frequently Asked Questions
- Publications

In addition to providing basic information about the impact of plan fees on retirement savings, the DOL has resources that are designed to educate plan sponsors and participants about the fee disclosures they receive. Among the resources the DOL has developed is a bi-weekly electronic newsletter to which individuals may subscribe, titled *Before It's Too Late: A Retirement Security Newsletter*. Links to this DOL web wage and other resources focused on plan fees are provided in the Appendix.

Who Does What?

With so many players involved in disclosing and analyzing plan fees under the DOL regulations, it can be difficult to keep track of just who does what. Here's a high level overview of the various players involved in fee disclosure.

Who	Fee Disclosure Responsibility
DOL	• Regulatory guidance • Enforcement • Fiduciary and participant information, education, and tools
Service Provider	• Provide fee disclosure to plan sponsors prior to entering into a service relationship • Disclose revenue sharing
Plan Sponsor/Plan Fiduciary	• Engage necessary services and pay only reasonable fees from plan assets • Collect and analyze fee information prior to entering into a service provider relationship • Benchmark fees • Provide fee information to participants (typically with support of recordkeeper and other service providers)
Retirement Plan Advisor	• Disclose fees to plan sponsor • May assist plan sponsor in collecting and analyzing fee information • May provide support for fee benchmarking • May deliver fee education to participants
Participant (Participant-directed plans)	• Receive certain fee information annually • Receive information regarding fees actually paid from their plan balance quarterly • Take fees into account when making investment selections and when considering certain transactions and services under the plan that are subject to additional fees

Is My Retirement Plan Advisor an ERISA Fiduciary?

There are different service models for providing investment support services. Some advisors and investment consultants step into the role of an ERISA fiduciary – others do not. Retirement plan advisors are not required to become ERISA fiduciaries when providing investment support services and guidance to the plan sponsor and plan participant, and many choose not to assume that role. Many of the traditional activities of advisors are considered non-fiduciary functions under the DOL regulatory framework, including:

- Researching and discussing a menu of investment options for the plan, assisting with the Investment Policy Statement (IPS).
- Providing investment performance reports and other information to the plan sponsor or investment committee.
- Providing generic investment education to plan sponsors and participants.
- Assisting with risk tolerance assessments or providing sample age and risk-based portfolios.
- Offering enrollment services.
- Helping monitor plan metrics, such as deferral rates.

Some advisors choose to expand their support services to assume additional investment responsibilities that make them an ERISA fiduciary, subject to the special standards of conduct defined by ERISA. There are two main paths to fiduciary status based on investment support:

- ERISA 3(21) Investment Advisor: One path to fiduciary status is as an investment advisor who delivers investment advice for a fee, under ERISA Section 3(21). While a 3(21) fiduciary agrees to be subject to the fiduciary standards with respect to their investment recommendations and submits to the DOL's enforcement jurisdiction, the plan fiduciary (typically the plan sponsor or an investment committee) retains ultimate legal responsibility for the selection and performance of the investments. A 3(21) investment advisor is sometimes referred to as a nondiscretionary fiduciary because the ultimate responsibility remains with the plan sponsor or investment committee.

- ERISA 3(38) Investment Manager: Under ERISA Section 3(38), a bank, insurance company, or registered investment adviser (RIA) may assume the role of an ERISA "investment manager." An advisor, who is not an RIA, cannot serve as an investment manager under ERISA 3(38). Investment managers assume full discretionary responsibility for selecting and monitoring plan investments, relieving the plan fiduciary of liability related to investment selection and performance. The role of an investment manager only exists if both the plan fiduciary and the investment manager have agreed, in writing, to the appointment. The plan sponsor is still considered a fiduciary because they are responsible for selecting the 3(38) investment manager.

Plan sponsors and other plan fiduciaries should discuss the various investment support service models, and the related costs, with their advisors or consultants.

ERISA 404(c)

ERISA Section 404(c) allows a plan sponsor to shift responsibility for investment selection to plan participants. As a plan fiduciary, the plan sponsor must prudently select a menu of investments for the plan. But if the requirements set forth in ERISA Section 404(c) are followed, the plan sponsor will not be responsible for the investment choices made by participants. Compliance with ERISA Section 404(c) is optional. To receive the benefits of ERISA Section 404(c), all of the following must be met.

- Participants must be allowed to choose from a broad range of investment alternatives. There must be at least three core investment options, though more than three are permitted. Each of the three core investments must have materially different risk and return characteristics. Each core investment must hold a diversified set of investments.
- Participants must be allowed to diversify among the three core investments.
- Participants must be allowed to make investment changes at a frequency that is appropriate in light of the market volatility of the investment, but at least quarterly.
- Participants must also receive sufficient information to make informed investment decisions, including the ERISA 404a-5 participant fee disclosures. Investment education is often delivered in educational sessions conducted by an advisor.

More in-depth guidelines for complying with ERISA 404(c) are provided in the Appendix (Complying With ERISA 404(c) Guidelines).

Industry Trends

How has the retirement industry reacted to the increased attention to plan fees?

- **Expanded disclosure.** The DOL fee disclosure regulations have led to more uniform and consistent disclosures of plan costs. The information is more readily available than it was in the past.
- **Broad variety of investment options and plan services.** The industry continues to offer a broad range of investment options and service models to accommodate the needs of plan sponsors. No single solution is required by the fee transparency rules.
- **Innovative benchmarking resources and cost comparison tools.** A variety of fee comparison tools and benchmarking resources have emerged to help plan sponsors and other fiduciaries determine whether their plan fees are reasonable.

Litigation Trends

With the heightened attention focused on plan fees, it is no surprise that plan costs have increasingly been the subject of lawsuits against plan sponsors and other fiduciaries. A case summary covering some of the most recent cases is included at the back of this Guide. Some of the common "themes" in these lawsuits are described below.

Failure to Explore Lower Cost Investment Alternatives

A number of the recent fee cases challenge a plan's selection of higher cost investment options when lower cost alternatives are available to the plan. These cases often focus on whether the plan has selected "retail" versus "institutional" share classes. While small retirement plans may only have the option to select "retail" share classes of mutual funds, larger plans often can invest in "institutional" class shares.

Some courts have held that a fiduciary's failure to explore lower cost alternatives is imprudent and, therefore, a breach of fiduciary duty. However, the courts will look at the specific circumstances in each case – and the lowest cost alternative has not always been found to be the best alternative for the plan. For example, retail shares will often provide "revenue sharing" back to the recordkeeper that can be used to offset the cost of recordkeeping. As a result, some plans that qualify for the institutional class shares may have opted to use retail shares to cover recordkeeping costs that would otherwise be debited from plan assets.

Some plaintiffs have alleged that excessive investment fees resulted from offering actively managed funds rather than other less costly alternatives such as index funds or collective trust funds. In other cases, the plaintiffs claim the investment committee or other plan fiduciaries were in breach of their fiduciary responsibilities because they failed to follow the terms of their Investment Policy Statement when selecting the more costly alternative.

Failure to Monitor Service Provider Fees

Another theme in fee-related litigation is a fiduciary's failure to monitor fees, resulting in payment of excessive fees to recordkeepers or other service providers. With the DOL fee transparency regulations now in effect, it should be easier for plan sponsors to review plan costs – including revenue sharing arrangements, which were at issue in some of the earlier service provider fee cases. Along with greater access to this information, however, comes greater exposure for plan sponsors and other fiduciaries that do not meet their fiduciary responsibility to collect and analyze fee information.

Key Takeaways and Action Items

Make certain you understand your responsibilities for monitoring plan costs and providing disclosures.

Begin by discussing educational opportunities and support available from your retirement plan advisor. Clarify your roles and responsibilities and those of your advisor and other service providers. To learn more, you may also want to check out the fee resources on the DOL website and the other educational resources listed in the Appendix.

Line up your resources.

Assemble the resources you need to monitor plan costs.

- Explore services available through your advisor or other service providers to help you select and monitor service providers.
- Research benchmarking resources like the *401(k) Averages Book* and plan comparison tools that will help you evaluate plan costs to ensure they are reasonable.

Plan Oversight: Procedures and Documentation

One clear lesson that emerges from the litigation trends is that fiduciaries must invest the time and resources it takes to understand the full range of fees being assessed against the plan and then analyze whether the fees are reasonable. Retirement plan advisors can help plan sponsors benchmark fees and review fees on an ongoing basis. One of the best ways to ensure that those responsibilities will be met on an ongoing basis is to develop written practices and procedures. Written checklists like the *Due Diligence Checklist* and the *Fiduciary Meeting Checklist* (included in the Appendix) provide a framework for fiduciaries to follow to ensure they consistently complete the essential tasks. These tools can also help plan sponsors and other fiduciaries document the due diligence steps they have taken to monitor plan fees.

Regulatory Framework

The DOL implemented its fee transparency initiative with two important regulatory projects: The ERISA 408(b)(2) service provider fee disclosure regulations and the ERISA 404a-5 participant-level fee disclosure regulations. These regulations are designed to ensure that plan sponsors and participants receive the investment and plan expense information they need to make informed decisions regarding their retirement plans. The service provider fee disclosure is the focus of this chapter of the Guide.

ERISA allows plan sponsors to enter into a contract with a plan service provider only if the services are necessary for the establishment or operation of the plan and no more than reasonable compensation is paid for the services. The DOL fee disclosure rules provide that an arrangement cannot be considered "reasonable" unless the service provider delivers certain required disclosures. If a service provider does not provide the required disclosures, causing a prohibited transaction, the consequences can be severe, including payment of excise taxes.

Plans and Service Providers Subject to the Regulations

These fee disclosure regulations apply to service arrangements and fees received in relation to:

- Defined contribution plans, such as 401(k) plans and profit sharing plans.
- Defined benefit plans.
- 403(b) arrangements that are subject to ERISA.
- Certain nonqualified plans.

Service providers are subject to the disclosure requirements if they enter into a contract or service arrangement with a plan and reasonably expect to receive compensation of $1,000 or more (measured over the life of the contract or arrangement) in connection with providing the services, and are:

- An investment adviser registered under the Adviser's Act or state law.
- An ERISA fiduciary.
- A recordkeeper or broker offering investments through a trading platform.
- Receiving "indirect" compensation.

Indirect compensation is compensation received from a source other than the plan, the plan sponsor, or the covered service provider. "Direct compensation" is compensation received from the plan, such as compensation paid directly from participants' accounts.

Disclosure Content

In their fee disclosures, service providers must disclose the following information for the services they (and their affiliates) provide to the plan.

- A description of the services they will provide
- A statement that the provider is an ERISA fiduciary or registered investment adviser, if applicable
- The direct and indirect compensation they expect to receive pursuant to the arrangement, including any fees related to termination of services, and how the compensation will be paid, such as billed directly or debited from plan assets
- The portion of fees related to recordkeeping services, including any revenue sharing or fee offset arrangements

The disclosure rules also outline investment expense disclosure requirements for service providers who are a fiduciary to a direct equity investment or who provide recordkeeping or brokerage services that offer a platform of investment options to participant-directed individual account plans.

Plan Sponsor Responsibilities

Plan sponsors must carefully review the disclosures they receive to:

- Assess the overall reasonableness of the fees for the services being performed.
- Identify potential conflicts of interest.
- Determine whether to continue, modify, or terminate the arrangements based on their findings.

Fiduciary Responsibilities for Plan Sponsors

Plan sponsors may engage service providers and compensate them from plan assets as long as:

- The services are necessary for the establishment or operation of the plan,
- No more than reasonable compensation is paid for the services, and
- All required disclosures are made.

Even if the contract itself is reasonable, compliance with Section 408(b)(2) is not fulfilled unless the required disclosures are provided.

Ongoing Responsibility to Monitor Service Arrangements and Fees

If the provider's services or fees change after the initial disclosure, the provider must issue an updated disclosure as soon as practicable. Disclosures of changes to investment-related information must be made at least annually. Plan sponsors must review the new disclosures to make the same determinations of reasonableness and conflicts of interest. Additionally, if plan sponsors are considering changing service providers or entering into a new service arrangement, they must receive fee disclosures from the new service provider reasonably in advance of the effective date of the arrangement.

If a service provider fails to disclose their fees as required under the regulations, the plan sponsor has a duty to request the missing information. Accepting services from a covered service provider who does not provide the required disclosures is generally prohibited by ERISA and is a breach of a plan sponsor's fiduciary responsibilities to the plan. The regulations provide relief for the plan sponsor if they send a written notice to the service provider requesting the information as soon as they discover the deficiency. If the service provider fails to respond within 90 days, the plan sponsor must notify the DOL of the service provider's failure and must consider terminating the service relationship to avoid engaging in a prohibited transaction. The DOL has developed an online *Fee Disclosure Failure Notice*, which enables plan sponsors to electronically notify the DOL if a service provider fails to provide the required notice. A link to the web page to submit the notice to the DOL is provided in the Appendix.

Fee Disclosure Compliance Checklist

Plan sponsors may want to create a compliance checklist to provide a framework for collecting and reviewing service provider fee disclosures. A checklist will also help plan sponsors document that they took the steps required by the rules. According to the DOL, "prudence focuses on the process for making fiduciary decisions" rather than the ultimate decision. In a fee disclosure compliance checklist, plans sponsors will want to:

- Identify who is responsible for overseeing service provider relationships and the related fee arrangements.
- Identify all covered service providers.
- Determine whether all service provider fees have been disclosed.
- Define procedures for ongoing reviews of fee disclosures, including documenting reviews.
- Define procedures for obtaining and reviewing benchmarking information for comparable plan services.
- Determine how the decisions regarding the reasonableness of plan fees will be tracked and recorded.

Plan sponsors may find the worksheets and other resources developed by the DOL helpful in complying with the disclosure regulations. The DOL's *Sample Guide to Initial Disclosures* is designed to help plan sponsors catalogue where to find specific fee information once they receive disclosures from their service providers. The DOL's *Tips for Selecting and Monitoring Service Providers* includes a list of issues plan sponsors should consider when selecting and evaluating service providers. Links to these DOL resources are provided in the Appendix.

What's a Reasonable Amount to Pay?

Understanding the vast array of plan costs is challenging enough for sponsors. But the law also requires that they assess whether those costs are reasonable. How does a plan sponsor know whether the fees they are paying are reasonable? Comparing a plan's costs to those of similar plans – called benchmarking – can provide a big part of the answer. But the level of services and the combination of fees for those services vary greatly from one service provider to another, which makes comparing fee arrangements challenging.

As illustrated in this chart, there is a vast range of investment fees and total bundled investment/recordkeeping/administration/trustee fees that a plan could pay, depending on the investment products and services it selects.

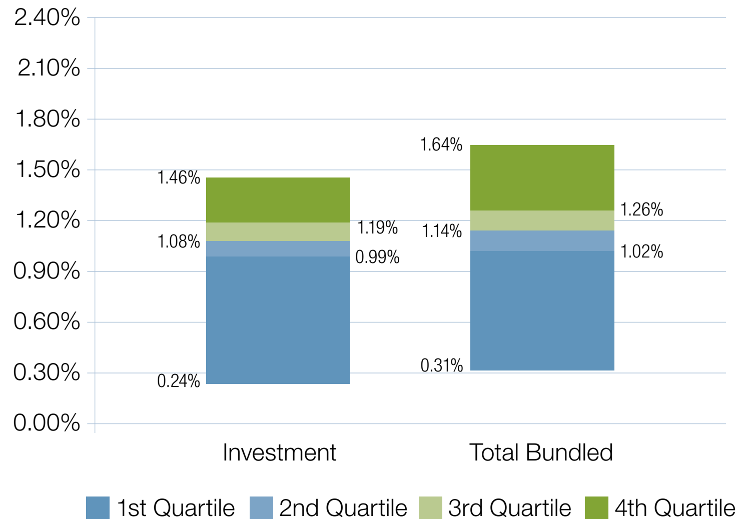
Plan sponsors may wish to tap into the expertise of their retirement plan advisor or a consultant for support. A variety of benchmarking methodologies and resources have been developed, which compare costs across a broad cross-section of service providers and products. An advisor can also help a plan sponsor identify and evaluate alternative service arrangements. A benchmarking analysis looks at comparative data not only to determine reasonableness of fees but to identify opportunities for improvement.

Finding Your Peers

Of all the plan characteristics that influence cost, plan size is the key driver and is critical in defining the peer group for benchmarking.

Investment and Total Bundled Cost Quartiles

($30MM Assets, 1,000 Participants, $30,000 Average Account Balance)



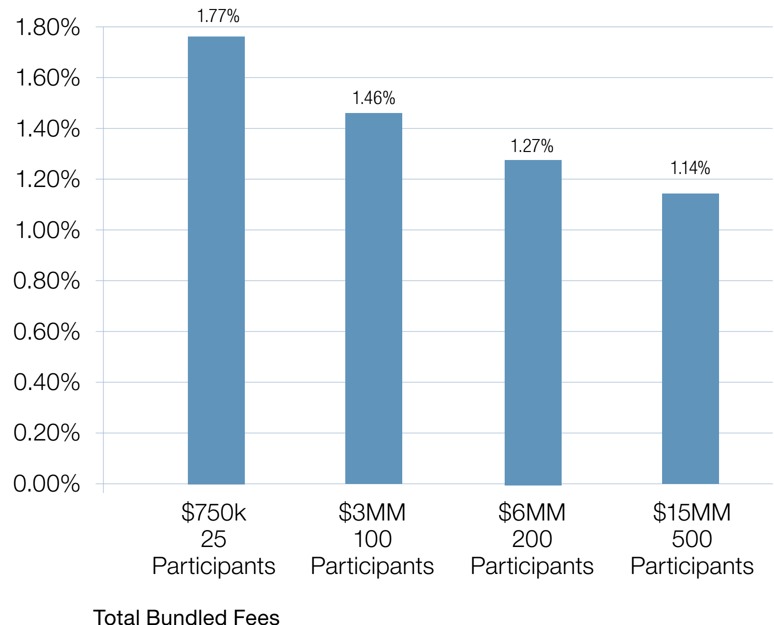
Source: *Data licensed from 401k Averages Book, 13th Edition*

Why Large Plans Pay Less

The main reason large plans (in terms of asset size) have access to lower-cost fee structures is economies of scale. That is, more assets give plan sponsors access to investment vehicles like institutional share classes that can spread investing costs over a larger base. As a result, individual participants pay less.

401(k) Plan Costs Differ by Plan Size

Average Plan Cost as a Percentage of Assets ($30,000 Average Account Balance)



Total Bundled Fees

Source: *Data licensed from 401k Averages Book, 13th Edition*

While larger plans generally have significantly lower costs than smaller ones (as a percentage of assets), there also can be a wide cost variance for plans of similar size. Consider two plans with the same level of assets and number of participants:

Sample Plan Costs

	Plan A	Plan B
Plan Assets	$30MM	$30MM
Plan Cost (% of Assets)	1.14%	1.64%
Total Plan Cost per Year	$342,000	$492,000
Number of Participants	1,000	1,000
Average Cost per Participant	$342	$492

Source: *Data licensed from 401k Averages Book, 13th Edition*

Is Plan B paying too much? Though similar in size, should these plans be in the same peer group? Consider some additional details:

	Plan A	Plan B	Implications
Participant Investment Allocations	Asset Allocation: 38% Large Equity, 20% Stable Value , 9% International Equity, 9% Fixed Income, 24% Balanced/ Target Date	Asset Allocation: 38% Large Equity, 20% Stable Value, 9% International Equity, 9% Fixed Income, 24% Balanced/ Target Date	Even though the asset allocations for Plan A and Plan B are the same, some of the investment products in Plan B have higher investment expenses. This could be the result of the funds being actively managed, or additional services performed by the product provider.
Employee and Employer Contribution Rate	10%	5%	Plans with higher contribution rates typically have lower costs since plan sponsors can anticipate higher asset levels and access better pricing.
Co-fiduciary Support	No	Yes	Advisors providing ERISA 3(21) fiduciary services typically charge a flat fee rather than being compensated through commissions or 12b-1 fees. Fiduciary support services can raise total plan expenses.
Participant Education	No	Yes	Advisor services such as on-site enrollment meetings, participant education materials, and one-on-one participant consulting can add expenses to service arrangements. More locations and geographic dispersion often further increase costs.

Differences in plan characteristics help explain why similar size plans can have cost structures that vary significantly. Many variables can impact plan costs, including industry type, geography, number of locations, employee and employer contribution rates, enrollment practices, and the range and quality of services. When benchmarking your plan expenses, be sure to not focus only on comparables for plans similar in size and industry, if possible, but also to benchmark comparable investment products and services.

The Bottom Line

A benchmark study is not something you do once and then put on a shelf. Most plan sponsors perform periodic reviews, at least once every three years. Some services may warrant benchmarking even more frequently, for example, annually. There is no bright line test to find out whether a plan is paying too much. While it's important to know how much the plan is paying for services and how that compares to similar plans, the plan sponsor needs to evaluate fees in the context of the value of the services being delivered. A plan sponsor is not restricted to using the lowest cost options – they are required to pay reasonable fees. Working with a retirement plan advisor to benchmark plan services and costs goes a long way toward ensuring the plan sponsor is fulfilling their fiduciary obligations and responsibilities to plan participants.

Given the complexity of comparing plan services and fees, benchmarking can be a daunting task. Consider these steps to make it easier.

- Plan advisors or other service providers can help plan sponsors establish suitable benchmarks. Plan sponsors may also want to explore helpful benchmarking tools, such as the 401(k) Averages Book.
- Break down the process into smaller parts.
  1. Compare total plan costs to benchmarks.
  2. Compare individual components – investment management fees, recordkeeping, trust/custody, and other fees – to benchmarks specific to these components.
  3. Compare quality of services at both the plan and participant levels.

     Plan Services

     - Investment management services
     - Management reports
     - Plan documentation
     - Government reporting
     - Investment reviews

     Participant Services

     - Quarterly statements
     - Participant call center support
     - Internet access
     - Benefit responsiveness
     - Communication and educational materials

     Comparing costs and services against benchmarks is easier than comparing value. To assess the quality of the services a plan receives, obtain a detailed description of the features, as well as measures of accuracy and processing time. Plan sponsors may find that they can solicit this information from service providers by issuing Requests for Proposals (RFPs) or Requests for Information (RFIs).

4. Keep records of benchmarking and RFP/RFI information in a plan file to document the process.

Anticipated Enforcement Strategy

Each year, the DOL protects millions of dollars of plan assets through its enforcement initiatives. With the spotlight on plan fees, plan sponsors can expect that enforcing the 408(b)(2) service provider fee disclosure regulations is high on the DOL's enforcement plan. The DOL will be on the lookout to ensure that a plan sponsor is meeting its fee monitoring and disclosure responsibilities.

To demonstrate compliance with these requirements, plan sponsors should be able to show that they received all required disclosures, and that they followed an appropriate process to review the disclosures to determine reasonableness.

Key Takeaways and Action Items

Consider Adopting a Fee Policy Statement.

A Fee Policy Statement provides a basis for disciplined expense management. Creating a policy gives you a set of guiding principles, along with a framework for decision-making and documenting processes. A Fee Policy Statement should provide enough direction to guide your decision-making philosophy, but not be so specific as to limit your options of service providers or investments.

Tap into the expertise of your retirement plan advisor to develop a process for evaluating plan fees.

To ensure you continue to fulfill your fiduciary responsibilities for monitoring service provider arrangements and plan expenses, consider developing a fee disclosure compliance checklist. Your compliance checklist should include specific actions that you will take and the criteria you will use to conduct ongoing evaluations of your plan service providers — and will serve as a written record of your compliance. Tap into the expertise of your advisor. Many retirement plan advisors include service provider selection and monitoring in their menu of services.

Benchmark fees.

Benchmarking your plan's investment and administration fees against other service providers who deliver comparable investments and services is an important step in determining whether the fees your plan is paying are reasonable. Cost is not the only factor to consider, however. The value of services or benefits to your plan, such as high service standards and effective participant communications, should be considered when making cost-benefit decisions and determining whether your plan fees are reasonable for the services received.

What to Include in a Fee Policy Statement

Service Provider Standards

✓ Cost management objectives for the plan that reflect a commitment to keeping costs reasonable for the services provided
✓ Itemization of services to be provided and standards for each provider, including expectations for costs and performance
✓ Formal service agreements with each provider to strengthen ability to meet regulatory requirements
✓ Process and schedule for reviewing service offerings and expenses, including benchmarking studies
✓ Standard disclosure and transparency requirements for service providers to ensure regulatory compliance

Investment Management

✓ Periodic reviews and updates of Investment Policy Statement
✓ Periodic reviews of investment selections, costs, and alternatives

Performance Review and Benchmarking

✓ Schedule for total plan cost audit and projections (e.g., annually)
✓ Schedule for review of service provider costs and performance against agreed-upon standards
✓ Schedule for benchmarking analysis (e.g., once every two years)

Participant Communications

✓ Communications strategy and policy with focus on:
– Making information clear and comprehensible
– Reporting to participants in ways that are meaningful and timely
✓ Audit of current fee disclosures to participants
✓ Comparison of plan fee disclosure practices with those of other plans
✓ Confirmation of compliance with regulatory requirements

Legal and Regulatory Developments

✓ Ongoing process for monitoring legal and regulatory developments for costs management and fee disclosure
✓ Identification of anticipated changes and development of a strategy to address them

The DOL designed the ERISA 408(b)(2) regulations, discussed in Chapter 4, to ensure that plan sponsors have the service provider and investment expense information they need to prudently perform their fiduciary duties to the plan. Through the ERISA 404a-5 regulations, the DOL also hopes to ensure that the estimated 72 million participants covered by 401(k)-type retirement plans have the information they need to understand how plan expenses and investment fees impact their retirement plan account balance so that they can make informed decisions about their retirement plan investments. This section of the Guide will describe the requirements for satisfying the participant-level disclosure regulations.

Rules Overview

Under the ERISA 404a-5 regulations, if a retirement plan delegates investment responsibilities to plan participants, the plan must inform participants of their rights and responsibilities for selecting plan investments, and explain how plan administration and investment expenses are paid.

Plans and Participants Subject to Disclosure

The participant-level fee disclosure requirements apply to participant-directed individual account defined contribution plans such as:

- 401(k) plans
- ERISA 403(b) plans

These disclosure requirements do not apply to:

- A plan where the plan sponsor or an investment manager manages all investments, such as a defined benefit plan.
- A plan that is not subject to ERISA, such as a non-ERISA 403(b) plan, a SIMPLE IRA plan, or an SEP (IRA) plan.

All eligible employees and all plan participants in plans subject to the disclosure regulations must receive the participant-level fee disclosures. This includes:

- Current plan participants
- Employees who meet the eligibility requirements but have not yet enrolled in the plan or have chosen to opt out of participating in the plan
- Former employees who have an account balance in the plan
- Beneficiaries of deceased participants

Roles & Responsibilities for Generating Disclosures

The person with discretion over how the plan is administered (i.e., the ERISA plan administrator) is responsible for providing the disclosures. This means that plan sponsors are generally responsible under the DOL regulations for providing fee disclosures to participants. However, in most cases, the plan recordkeeper or other service providers will assist plan sponsors in creating and delivering these participant notices.

Annual Disclosures

Participants must receive disclosures of plan-related and investment information on or before the date they can first direct their investments, and at least once every 12 months thereafter.

Plan-Related Information: The disclosure must include “general plan information” to explain how the plan operates. This includes a list of investments available under the plan, instructions on how to make an investment election, and a description of any “brokerage window” available within the plan. The disclosure must also explain fees and expenses for plan administration, such as recordkeeping fees, legal expenses, and accounting expenses. Fees for general plan administration services may be paid by the plan sponsor, may be deducted from the accounts of all participants in the plan, or paid through revenue sharing arrangements. In most 401(k) plans, at least a portion of the general administration fees are deducted from the accounts of the participants in the plan. The disclosure must explain how the fees are assessed, for example, as a flat dollar amount for all participants or pro rata based on a participant’s percentage of overall assets in the plan.

In addition to the administrative fees that cover services common to all participants in the plan, the disclosure must list other fees that might be charged to a specific participant's plan account, rather than allocated across all plan participants' accounts. These fees relate to optional services that the participant selects or specific transactions the participant initiates. Common examples include fees for taking a loan or a distribution, using investment advice services, submitting a qualified domestic relations order, or accessing a brokerage window.

Investment Information: Investment-related information also must be included in the annual fee disclosures to participants. Participants must receive this information in a comparative format, such as a chart, listing each designated investment alternative offered under the plan. Most participant fee disclosures are designed to incorporate the DOL model comparative chart that was included in the fee regulations.

Performance Information

Variable Return Investments

Name/ Type of Option	Average Annual Total Return as of 9/30/12				Benchmark			
	1 year	5 year	10 year	Since Inception	1 year	5 year	10 year	Since Inception
Equity Funds								
XYZ Fund Mid-Cap Value www.xyz.com	18.7%	1.70%	9.50%	9.50%	13.30%	2.45%	7.01%	N/A
					Midcap Value Index			
Acme International Fund International Stock www.Acmeinternational.com	-13.99%	-2.48%	7.58%	7.58%	-13.82%	-5.68%	5.14%	N/A

Average Annual Total Return as of 9/30/12			
1 year	5 year	10 year	Since Inception
18.7%	1.70%	9.50%	9.50%
-13.99%	-2.48%	7.58%	7.58%

Performance data, such as average annual total return, is an important portion of the chart. The "average annual total return" is defined as the yearly average percentage increase or decrease in an investment's value (i.e., the profit or loss for each fund).

The annual disclosures must provide for each designated investment alternative the average annual returns for the past year, the past 5 years, and the past 10 years (or since inception if a shorter period) to help participants compare how each fund has performed historically. Of course, historical performance does not predict future performance; this is just one of the factors participants should consider when evaluating investments.

Performance Information								
Variable Return Investments								
Name/ Type of Option	**Average Annual Total Return as of 9/30/12**				**Benchmark**			
	1 year	**5 year**	**10 year**	**Since Inception**	**1 year**	**5 year**	**10 year**	**Since Inception**
Equity Funds								
XYZ Fund Mid-Cap Value www.xyz.com	18.7%	1.70%	9.50%	9.50%	13.30%	2.45%	7.01%	N/A
					Midcap Value Index			
Acme International Fund International Stock www.Acmeinternational.com	-13.99%	-2.48%	7.58%					

Benchmark			
1 year	**5 year**	**10 year**	**Since Inception**
13.30%	2.45%	7.01%	NA
Midcap Value Index			

Benchmark information must also be included on the comparative chart. A benchmark is a group of investments whose performance is used as a standard or index to compare investment performance. A relevant benchmark must be provided in the comparative chart for each variable investment in a plan's investment lineup. Different benchmarks must be provided for different types of investments, so participants can see how other funds in a similar category performed compared to their plan's investment options.

Fees and Expenses			
Name/ Type of Option	**Total Annual Operating Expenses**		**Shareholder-Type Fees**
	As a %	**Per $1000**	
Equity Funds			
XYZ Fund Mid-Cap Value	1.45%	$14.50	Redemption Fee: 2.0% for sales within 2 months of purchase
Acme International Fund International Stock	1.50%	$15.00	N/A

Total annual operating expenses are another required component of the comparative chart for each plan investment. Expenses must be listed as both a percentage of assets and as a dollar amount (based on each $1,000 invested). These costs reduce the overall return (the average annual total return) of the fund.

In addition to the costs of operating and distributing a fund, there may also be service charges or fees referred to as "shareholder-type fees" that are assessed when participants purchase or sell shares. These fees are typically charged directly to the participant's account and are in addition to the annual operating expenses. In many cases, 401(k) investments will not be subject to shareholder-type fees, and the comparative chart will either be left blank or contain the phrase "not applicable" or "N/A" in the shareholder-type fee column.

The participant-level annual disclosures must also include:

- An Internet web site address where participants can obtain additional information.
- A glossary of terms to help participants understand their investments options.
- Certain statements to help participants understand the relative importance of plan fees and the impact fees have on their account. For example, there must be a statement indicating that fees and expenses are only one of several factors that participants should consider when making investment decisions.

The disclosure rules outline special requirements for different types of investments, such as annuities and employer securities.

Quarterly Disclosures

At least once per quarter, or every three months, participants must receive a statement listing the actual dollar amount charged to or debited from the participant's plan account for administrative services for the previous quarter, and a description of the services. This includes actual charges for use of a brokerage window. If a portion of the expenses was paid via revenue sharing, the quarterly disclosure must explain that as well. Participants' quarterly account statements aren't required to list the precise amount of fees being paid through revenue sharing because the amount will fluctuate depending upon a number of circumstances, such as the amount of plan assets invested in each fund that provides revenue sharing. Different funds may pay different rates of revenue sharing.

Helping Participants Understand Disclosures

Plan participants may have questions about what the fees listed in their disclosures are for and why they are paying these fees. They may not have a strong grasp as to how plan costs are allocated among participants or how investment fees affect the total return on their investments.

Plan sponsors can look to their plan advisors and other service providers for help in developing a fee education program. In an education program focused on plan fee disclosures, participants can learn how fees are paid in their plan and walk through the information included in the disclosures they receive. The DOL and other industry organizations have created free educational resources that may be helpful to incorporate in a fee education program.

- The DOL's *A Look at 401(k) Plan Fees* brochure educates plan participants about the types of fees that may apply to a 401(k) plan. A link to this brochure is included in the Appendix.
- The SPARK Institute, jointly with a number of industry organizations, developed the *Sample Glossary of Investment-Related Terms For Disclosures to Retirement Plan Participants.* This glossary may be used to satisfy the glossary of terms requirement under the participant-level disclosure regulations. A link to this resource is included in the Appendix.

Many participants may also benefit from a general investment education program. Advisors can explain the risk and return characteristics of various types of investments, as well as why some investments are more expensive than others and why the benefits of those investments might, in some cases, offset the higher cost. Plan sponsors may want to consider customizing their investment education programs to various groups of employees to make the education more meaningful. Certain age groups may also find general financial education, such as debt reduction strategies or information on saving for college, as valuable as investment education.

Key Takeaways and Action Items

Ensure your plan is in compliance with the disclosure requirements.

Although you will likely rely on your recordkeeper or other service provider to help compile the fee information and deliver the disclosures to participants, as the plan sponsor and ERISA plan administrator of your plan you have the fiduciary responsibility to ensure that your participants receive the information required under the participant-level fee disclosure regulations. Here are some tasks you may want to incorporate into your process for ensuring that your plan is in compliance with the disclosure requirements:

- Review the format for the annual and quarterly disclosures each year to ensure all designated investment alternatives are disclosed and all of the required information for each investment is included.
- Review the timeline for delivering the disclosures, including the process for ensuring newly eligible participants receive information on a timely basis.
- Make certain there is adequate documentation regarding the actual delivery of disclosures.

Your retirement plan advisor can help you work with your service providers to identify any issues in satisfying these disclosure requirements.

Review your participant-level fee education program.

Some of your participants will have questions about the fee disclosures they receive. Review your participant-level fee education program to ensure that it addresses likely participant questions. The DOL and other industry organizations have created free educational resources that may be helpful to incorporate in a fee education program.

Also consider creating general financial and investment education programs targeted to specific groups among your employees.

- Evaluate the need for investment education among your newly eligible population versus employees who have a history of plan participation with you or a former employer. Ongoing investment education is important for all employees, but the tone of the message may change for employees just beginning to save for retirement as compared to those who have been participating in the plan for years.
- Address the financial education needs for employees of different age groups. Younger employees may be more concerned about saving to buy a house or starting a family than saving for retirement.

Anticipate Participant Fee Questions

Why are plan administration fees being charged to my account?

Am I being charged fees for my plan investments?

What is an average annual return?

What is a benchmark?

Should I move all of my assets into investments with the lowest fees?

What is “revenue sharing”?

How will I know if my fees change?

Online Resources

Victory Capital Management

- Victory Capital Management Inc., an investment advisory firm with more than a century of investment management experience, manages assets for institutions and individuals – https://www.vcm.com

Pension Data Source, Inc.

- 401k Averages Book (updated annually), 401k Averages Book Fee Worksheet, 401k Book Service Summary Worksheet – www.401ksource.com

U.S. Department of Labor (DOL)

- *Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries* (http://www.dol.gov/ebsa/pdf/fsTDF.pdf)
- *Before It's Too Late: A Retirement Security Newsletter* http://www.dol.gov/ebsa/newsletter/archive.htm
- *Tips for Selecting and Monitoring Service Providers* – www.dol.gov/ebsa/pdf/fs052505.pdf
- *FAQs: Disclosures to Help Employees Understand Their Retirement Plan Fees* – www.dol.gov/ebsa/faqs/faq-disclosures.html
- *Sample Guide to Initial Disclosures* (found at the end of the ERISA 408(b)(2) Regulations) – http://webapps.dol.gov/federalregister/pdfdisplay.aspx?docid=25781
- *Fee Disclosure Failure Notice* web page – http://askebsa.dol.gov/fdfn/NotificationProcess
- *Model Comparative Chart* – www.dol.gov/ebsa/participantfeerulemodelchart.doc
- *A Look at 401(k) Plan Fees* – http://www.dol.gov/ebsa/pdf/401kFeesEmployee.pdf
- *Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure* – http://webapps.dol.gov/federalregister/PdfDisplay.aspx?DocId=25781
- *Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans* – https://webapps.dol.gov/federalregister/PdfDisplay.aspx?DocId=24323

U.S. Securities and Exchange Commission (SEC)

- SEC homepage – www.sec.gov
- Investor education – http://investor.gov

U.S. Government Accountability Office (GAO)

- Retirement Security Reports & Testimonies – www.gao.gov/browse/topic/Retirement_Security
- *401(k) Plans: Increased Educational Outreach and Broader Oversight May Help Reduce Plan Fees* – www.gao.gov/products/GAO-12-325

Congressional Committees

- Committee on Ways & Means – http://waysandmeans.house.gov/
- Joint Committee on Taxation – https://www.jct.gov/
- Congressional Committee Reports – www.gpo.gov/fdsys/browse/collection.action?collectionCode=CRPT

SPARK Institute

Sample Glossary Of Investment-Related Terms For Disclosures To Retirement Plan Participants – http://www.sparkinstitute.org/content-files/File/Part%20Disc%20Inv%20Terms%20Glossary%204-26-12%20FINAL.pdf

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Fiduciary Meeting Checklist

Review the Minutes from Previous Meeting and Approve

Conduct a Plan Review

✓ Recent changes in the law that may affect the plan since the last review
✓ Consider potential changes in plan design
✓ Review recent plan amendments
✓ Review procedures for required notices and disclosures, including fee disclosures
✓ Understand asset allocation trends based on participants' activity and other plan metrics

Review Plan Investments/Performance

✓ Relative and absolute fund performance — to measure how the funds' performance stack up against their peers and over various market cycles
✓ Risk/return characteristics — to measure each fund's risk and return relative to the overall market and its peers
✓ Adherence to style — to determine whether the fund manager is investing in the stocks mandated in the IPS
✓ Market cycle analysis — to determine if the plan is sufficiently diversified and make recommendations for funds to be eliminated or replaced

Review Participant Education and Communication

✓ Enrollment results since last meeting; discuss changes for future enrollment meetings; schedule next enrollment meeting
✓ Results of educational meetings since last review, discuss changes for future meetings; schedule next education meeting
✓ Review materials for appropriateness

Review the Plan Operations

✓ Service provider's performance against plan needs; service provider agreement including a review of fees and expenses
✓ Ensure that the plan contributions are being segregated and invested into the plan as soon as possible
✓ Ensure that the plan continues to qualify for relief under ERISA 404(c)

Due Diligence Checklist

Plan Fiduciaries

- ✓ Meet annually at a minimum (more frequently if providing investment oversight or circumstances warrant)
- ✓ Maintain a due diligence file with notes, minutes, agenda, and documentation of decisions
- ✓ Ensure that all fiduciaries are aware of their responsibilities under ERISA and that the investment fiduciaries are appointed in accordance with plan and trust documents
- ✓ Ensure that all eligible employees are included and that the plan collects and invests employee deferrals in a timely manner
- ✓ Ensure that the fidelity bond covers at least 10% of plan assets and that fiduciaries are carrying liability insurance to protect business and personal assets
- ✓ Review costs and understand all services provided, e.g., investment manager, fund companies and fees, plan administrator, advisors, consultants, etc.

Plan Investments

- ✓ Put the investment policy in writing
- ✓ Ensure the plan is adhering to the broad range requirement, e.g., stable value, bonds, mid/small/large cap equities, and international at a minimum
- ✓ Review the investments annually, at a minimum, compared to peer groups and appropriate indexes over 1, 3, 5, and 10 year periods — per the IPS
- ✓ Document the review and discussion about placing funds on a watch list, or removal — per the procedures in the IPS
- ✓ Ensure that the menu minimizes stock overlap

Communication

- ✓ Review employee enrollment programs and participation rates
- ✓ Measure participant understanding and address their needs accordingly
- ✓ Provide easy-to-use tools and asset allocation models to enhance their knowledge

Compliance with ERISA 404(c)

Provide participants with:

- ✓ Written notice of
  - Their ability to direct their own investments
  - Your intention to comply with ERISA 404(c)
  - Name, address, and phone number of fiduciary responsible for providing information upon request
- ✓ Information about each investment option in the plan and other information required by the ERISA 404a-5 regulations
- ✓ Access to investment education regarding investment concepts, e.g., types of investments, risk/return, impact of time horizon, etc. — at least annually

Provide the IRS and DOL with:

- ✓ Annual Form 5500 indicating the plan's intention to comply with 404(c)

Complying With ERISA 404(c) Guidelines

Section 404(c) of the Employee Retirement Income Security Act (ERISA) provides fiduciaries with the potential for some relief from responsibility if a participant incurs investment losses. By following the guidelines set forth in Section 404(c), a fiduciary may shift some of the responsibility for selecting plan investments to the participant and not be held liable for the participants' investment decisions.

The premise of these 404(c) guidelines is that if the plan offers participants a sufficient range of prudent investment choices and enough flexibility to reallocate among those investments, and participants receive sufficient information to make prudent investment decisions, then the plan sponsor and fiduciaries enjoy protection from liability for investment losses incurred as a result of the investment decisions made by participants.

An Investment Policy Statement is not a requirement for ERISA plans, but it does provide plan fiduciaries with a roadmap for an investment program and helps to document a due diligence process in case of a Department of Labor audit.

If you create an IPS, it is imperative that the investment committee (and other investment fiduciaries) follow the terms of the IPS.

Investment Guidelines

Does the investment menu offer sufficient diversification to minimize risk?

- Prudently select and monitor a menu of investment options and asset classes.
- Offer a broad range of options and include at least three "core" investments with materially different risk/return characteristics.
- Provide participants with the opportunity to affect risk/return characteristics and to diversify their portfolio to prevent large losses.
- Allow participants to change their core investments at least quarterly, and more frequently for any volatile investment option. (If a non-core investment option permits changes more frequently than quarterly, then a participant must be allowed to transfer into a core investment option at least as often.)
- Be sure all options are available to all participants.

The plan fiduciary must monitor the investment options to ensure that they meet the above criteria.

Communications Guideline

Have the participants received sufficient investment information to help them make informed investment decisions?

- Explain that participants are responsible for building their portfolios. Provide them with a statement that the plan is intended to comply with ERISA 404(c) and that plan fiduciaries may be relieved of liability for participant investment losses.
- If applicable, provide information on the confidentiality procedures for employer securities offered in the plan, including the named fiduciary responsible for monitoring compliance with the procedures.
- Provide the information required under the ERISA 404a-5 regulations for participant-level fee disclosures.

Complying With ERISA 404(c) Guidelines

Information Required Under the ERISA 404a-5 Regulations

Plan Sponsors Must Provide This Information to Participants Before They Can First Direct Their Investments and Annually Thereafter:

- A description of each investment alternative, including its objectives, risk/return characteristics, investment strategy, and identification of its investment manager information, and a description of any brokerage window or similar arrangement that enables participants to select investments beyond those designated by the plan
- An explanation of the procedures a participant must follow when giving investment directions
- A list of fiduciaries under the plan, including name, address, phone number, and what information they must provide to the participant upon request
- Information on the exercise of voting, tender, and other shareholder rights
- A comparative chart listing the performance and benchmark data, and fee and expense information for each designated investment alternative, including any shareholder type fees or restrictions on the participant's ability to purchase or withdraw from the investment
- An Internet web site address where participants can obtain additional information on the investment alternatives
- A glossary of investment-related terms
- Information on all administrative service fees or expenses that may be charged to a participant's account and how they will be assessed
- Statements to help participants understand the relative importance of plan fees, including that fees are only one of several factors that should be considered when making investment decisions

Plan Sponsors Must Provide This Information to Participants Quarterly:

- A statement listing the actual amount charged in the previous quarter for administrative services and a description of the services
- If applicable, a statement indicating that a portion of the expenses was paid through a revenue sharing arrangement

Plan Sponsors Must Provide This Information Upon Participant Request:

- Copies of any prospectuses, financial reports, and statements of valuation and of assets held by an investment option

This information is intended as an overview of Section 404(c), not as a checklist to determine compliance.

Glossary of Retirement Plan Terms

401(k) Plans: Employer-sponsored defined contribution plans in the private sector that allow employees to contribute a portion of their compensation into the plan.

403(b) Plans: Defined contribution plans established for employees of certain tax-exempt organizations and public schools, and for self-employed ministers and their employees.

404(a)(1)(A) and (B): The section of Title I of ERISA that establishes the duties of a plan fiduciary, which are to act solely in the interest of participants and beneficiaries. This section includes the stipulation that the fiduciary must ensure plan expenses are reasonable for services provided. The final rule, which became effective in 2012, provides that:

- The investment of plan assets is a fiduciary act governed by the fiduciary standards in ERISA section 404(a)(1)(a) and (b), which require plan fiduciaries to act prudently and solely in the interest of the plan's participants and beneficiaries.
- When a plan allocates investment responsibilities to participants or beneficiaries, the plan administrator must take steps to ensure that such participants and beneficiaries, on a regular and periodic basis, are made aware of their rights and responsibilities with respect to the investment of assets in their accounts and are provided sufficient information regarding the plan and the plan's investment options, including fee and expense information, to make informed decisions with regard to their individual accounts.

404(c): A section of Title I of ERISA that protects plan fiduciaries from liability for the results of decisions made by plan participants who direct the investments in their accounts, provided certain conditions are met. Plan fiduciaries are still responsible for prudently selecting and monitoring the investment options available to plan participants.

408(b)(2): A section of Title I of ERISA that provides plan sponsors certain protections as long as an arrangement or contract with a service provider is reasonable, the services provided are necessary, and no more than reasonable compensation is paid for services. In 2012, DOL rules that require expanded disclosure and transparency under Section 408(b)(2) became effective. These rules are designed to ensure plan sponsors receive clear and complete information about provider compensation and services.

The new regulation applies to defined contribution plans and defined benefit pension plans and addresses the disclosure of the direct and indirect compensation certain service providers receive.

Actively Managed Funds and Accounts: Investment strategies in which the manager actively constructs a portfolio of securities to generate a return that exceeds a benchmark.

Administrative Service Fees: Fees typically paid by a fund for recordkeeping, administration, and other account services.

Annuity Investments: Products offered by insurance companies that are widely used in retirement plans, with plan assets frequently packaged on a group annuity platform. The participant typically has a pooled investment account with a contract for insurance-related elements and charges, such as an annuity feature, interest and expense guarantees, and any death benefit provided during the contract term.

Basis Point (BPS): A unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument.

The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security. The relationship between percentage changes and basis points can be summarized as follows: 1% change = 100 basis points, and 0.01% = 1 basis point.

Benchmarking: Analysis providing defined contribution plan peer group comparisons of cost and service levels; used by plan sponsors to help assess whether fees are reasonable for services received.

Brokerage Window: An investment option that allows participants to select investments beyond those offered under the plan's menu of designated investment alternatives. Also called a self-directed account or self-directed brokerage account.

Bundled and Unbundled Service Plans: In bundled service arrangements, the sponsor hires one company to provide a full range of retirement plan services directly or through subcontractors. In unbundled arrangements, the sponsor uses a combination of service providers directly.

Collective Trust Fund (CTF): A tax-exempt, pooled investment vehicle administered by a bank or trust company that is available to defined benefit and defined contribution plans.

Conflict of Interest: Relationships with other parties or interests that impact a provider's or other interested party's ability to act in the best interest of the plan and its participants.

Custody/Trustee Expenses: Charges for safekeeping of defined contribution plan assets.

Defined Benefit Plan: An employer-sponsored retirement plan where employee benefits are based on a formula using factors such as salary history and duration of employment. Investment risk and portfolio management are entirely under the control of the company. There are also restrictions on when and how a plan participant can withdraw these funds without penalties.

Defined Contribution Plan: A retirement plan in which a certain amount or percentage of money is contributed to a plan for the benefit of participating employees. The employee's benefit is based on the total amount contributed, plus earings. There are restrictions as to when and how a plan participant can withdraw these funds without penalties.

Department of Labor (DOL): Federal department responsible for overseeing retirement plans. A unit of the DOL, the Employee Benefits Security Administration (EBSA) is responsible for ERISA enforcement.

Designated Investment Alternative: Any investment designated by the plan into which participants may direct the investment of assets held in their individual accounts.

Direct and Indirect Compensation:

Direct: Compensation paid directly by a plan sponsor to plan service providers. More easily identified and reported than indirect compensation, direct compensation includes fees paid by sponsors to providers using plan assets, including amounts deducted from participant accounts.

Indirect: Compensation received by service providers from any source other than the plan, plan sponsor, an affiliate or a subcontractor. Since providers use a wide variety of service models, fee structures and products, there are many different types of indirect compensation. More complex than direct compensation, indirect compensation can be difficult to identify and report.

Distribution (12b-1) Fees: Fees paid by some funds to cover sales and marketing expenses and sometimes shareholder service expenses. In defined contribution plans, these fees may be paid by funds to financial advisors for retirement plan services, including communications, investor education, and related services.

Due Diligence: An investigation or audit of a potential investment. Due diligence serves to confirm all material facts in regard to an investment selection. Generally, due diligence refers to the care a reasonable person should take before entering into an agreement or a transaction with another party.

Employee Retirement Income Security Act of 1974 (ERISA): A federal law that sets minimum standards for most voluntarily established retirement and health plans in the private sector to provide protection for plan participants. Title I of ERISA covers fiduciary standards applicable to employee benefit plans. ERISA is enforced by the U.S. Department of Labor.

Expense Ratio: The costs to operate an investment, expressed as a percentage of assets or in basis points. These costs are reflected through a reduction in the investment's rate of return. (See Total Annual Operating Expense.)

Fee Policy Statement: A written policy that provides guidelines and objectives for plan expense management and a framework for decision-making and documenting cost control processes.

Fee Types	Charges Based On	Examples
Asset-based	Amount of plan assets, typically expressed as percentages or basis points	Investment expense, annuity fee
Per-person	Number of participants in plan or number of eligible employees	Education and enrollment fees
Transaction-based	Execution of particular plan service or transaction	Loan origination fee, distribution expense
Flat rate	Fixed charge that does not vary	Annual audit fee

Fiduciary: An individual or entity that manages an employee benefit plan and its assets. Fiduciary status can arise from being named or appointed as fiduciary or can be based on the *functions performed for the plan*. Plan fiduciaries typically include the trustee, investment advisors, individuals exercising discretion in the administration of the plan, plan administrative committee members, and those who select committee officials. The key to determining whether an individual or an entity is a fiduciary is whether they are exercising discretion or control over the plan.

Form 5500 Schedule C: Annual report filed for employee benefit plans. Includes reporting requirements for service provider fees and other compensation.

Group Annuity Contracts: See Annuity Investments.

Index: A measurement of a specific selection of stocks that represent the stock market. A market index is used to benchmark fund performance.

Insurance-Related Charges: Fees for sales expenses, mortality risk charges, and the cost of issuing and administering the annuity contract.

Investment Consulting Fees: Expenses for consulting and plan advice on issues such as the Investment Policy Statement drafting and investment manager due diligence, selection, monitoring, and fee negotiation.

Investment Management Expenses: Fees charged by the fund's investment advisor for managing securities in the portfolio. Expenses vary depending upon investment strategy. These charges represent the vast majority of plan expenses.

Investment Policy Statement (IPS): A written policy used as a guideline for investment decisions by plan fiduciaries. An IPS may include definitions of acceptable asset classes, due diligence approach, and fee guidelines for investment products.

Mutual Fund Share Classes: Mutual fund companies may provide a multi-class share structure to pay for the advisory and administrative services offered to different types of investors in the same portfolio. For defined contribution plans, the most common are R, A, and I shares, each tailored to the requirements of different plan sizes. Because R- and A-share classes typically carry distribution (12b-1) and sub-transfer agency fees to fund the servicing needs of small- and mid-size plans, operating expenses tend to be higher than for the I-share-class funds used in large and mega plans.

Non-Settlor Functions: Plan expenses that may be paid from plan assets. Examples include costs for drafts of plan amendments for changes required by law, benefit calculations, and nondiscrimination testing.

Open Architecture: This structure refers to trading and recordkeeping operations that make a wide range of investment vehicles and service options available to a retirement plan.

Passively Managed Funds and Accounts: Investment strategies with the objective of matching the return of an index. Also known as index funds.

Plan Participant Account Statement: ERISA-required disclosure of account balances due to a plan participant.

Plan Sponsor: A designated party, usually a company or employer that sets up a healthcare or retirement plan, such as a 401(k) for the benefit of the organization's employees. The responsibilities of the plan sponsor include determining eligibility parameters, investment choices and, in some cases, providing plan contributions in the form of cash and/or stock.

Proprietary Systems: Platform structures making only one investment provider available to a plan sponsor.

Recordkeeping Fees: Fees associated with plan operations and administration services, including transaction processing, reporting, transfers, valuations, participant inquiries, statement preparation, and distributions.

Revenue Sharing: Revenue sharing occurs when investment providers pay other plan service providers for product distribution or recordkeeping/administrative services, or "share" or rebate a portion of fees to these other providers.

Separately Managed Accounts (SMAs): Institutionally managed portfolios of securities for investments that are owned directly by the account holder.

Service Providers: Vendors providing services to a plan such as custody/trustee, investment advisory, investment management, recordkeeping, brokerage, consulting, banking, third-party administration, fiduciary, accounting, actuarial, audit, legal, and valuation services.

Settlor Functions: Costs associated with the establishment of ERISA plans. Generally, settlor expenses must be paid by the plan sponsor and not from plan assets or revenue. Examples include costs for conducting a plan design study, amending the plan for non-legally required reasons, and correction of compliance and fiduciary errors.

Stable Value Fund: A conservative investment available in 401(k) and certain other savings plans. Stable value funds are designed to preserve principle and provide consistent returns and liquidity.

Sub-Transfer Agency Fees: These fees are paid by funds for defined contribution plan services provided by recordkeepers, trust companies, third-party administrators, or banks.

Summary Annual Report (SAR): ERISA-required disclosure to plan participants on the financial condition of the retirement plan. The SAR is a summary of information included in the annual report (Form 5500) and must be provided to participants within nine months of the close of the plan year.

Summary Plan Description (SPD): ERISA-required document explaining how the retirement plan operates. The SPD must be provided to plan participants and beneficiaries and includes information on participant eligibility, employee rights, vesting, and claims and appeal provisions.

Surrender and Transfer Charges: Fees that may be assessed if the employer terminates an annuity contract early and assets are transferred to another investment option.

Total Annual Operating Expense: Expenses for investment management, distribution (12b-1), and other functions, including services and administration. Expenses vary depending upon share class and investment strategy. (See Expense Ratio.)

Total Revenue Credit: Revenue sharing available to offset recordkeeping, administration, and investment consulting charges.

Total Revenue Sharing Debit: A shortfall that occurs when revenue sharing does not generate enough to pay for recordkeeping, administration, and investment consulting charges; must be paid by the plan, plan sponsor or a combination of the two.

Trading Costs: Transaction costs and brokerage fees for trades. Trading costs are charged against fund value and are not included in the total operating expense ratio. Costs vary depending on portfolio turnover and market liquidity.

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