GUIDE TO RETIREMENT PLAN FEES

THREE-PART EXPERT VIEW FEATURE

FRANCIS INVESTMENT COUNSEL LLC

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Executive Summary

An easy target on a plan sponsor's back is the allegation of unreasonable fees charged within the retirement plan. Allegations of unreasonable fees have dominated the headlines of ERISA litigation for years, and this trend will only continue to grow.

How do plan sponsors protect themselves? The courts do not suggest lowest costs as a safe haven. Instead, precedent points to the fiduciary's duty to maintain a reasonable cost structure with evidence that oversight of participant fees occurs.

As a plan sponsor, you need to clearly identify the fees incurred by your retirement plan and demonstrate a prudent process for monitoring these fees. Through the following three-part Expert View feature, you'll gain an understanding of the major cost components within your retirement plan, the options you have for paying those costs, and strategies for allocating costs to plan participants.

Part One: **The "Big Three" Retirement Plan Fees (access directly)**

Part Two: **How to Pay Retirement Plan Fees (access directly)**

Part Three: **Plan Participant Cost Allocation Strategies (access directly)**

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PART ONE: THE “BIG THREE” RETIREMENT PLAN FEES

Participant directed retirement plans come with a number of operational costs including plan recordkeeping, trust and custodial services, plan audit, legal counsel, investment advisory services, and plan participant education and advice services. That’s a lot to keep track!

Our Guide to Retirement Plan Fees outlines how plan sponsors can go about managing these costs. It also provides strategies for allocating costs to plan participants. But the first step in managing costs is identifying and understanding them. Here we address the three major cost components in a participant directed retirement plan and how to best keep these costs in check.

1) Asset Management

Asset management is the largest single cost to your retirement plan and, therefore, your plan’s participants. Asset management is expressed in the form of expense ratios. Each investment you select for your plan’s investment menu has a stated expense ratio.

What is often not clear regarding fund expense ratios is that they may include more than the fees paid to the asset management firm. This “more” refers to something called revenue sharing (12b-1 fees). Revenue sharing is in addition to the investment manager’s fee and is used to compensate other plan service providers such as your recordkeeper or advisor.

Because revenue sharing is included in (rather than separated from) the fund’s stated expense ratio, it represents a concealed cost. Additionally, because revenue sharing is asset based, it grows as the plan’s assets increase. This translates to automatic pay raises for all providers compensated through revenue sharing, all while hidden from plan participants.

How to Keep Asset Management In Check

As a plan sponsor, you control asset management costs based on the investment share classes you select. Investment managers have a wide selection of share classes from which to choose and each one will impact the plan’s cost structures differently. We advocate plan sponsors seek the lowest possible cost shares for which your plan will qualify, and when possible, eliminate share classes with revenue sharing built into their pricing. By doing so, you will improve transparency and obtain greater control over the plan’s overall cost structure.

If you are not able to eliminate all revenue sharing, consider building rebates into your participant cost allocation methodology. We detail this further in Part Three of our Guide to Retirement Plan Fees.

2) Recordkeeping, Trust and Custodial

The plan’s recordkeeper performs a host of critical daily administrative functions for the plan, including maintaining the individual participant accounts, providing plan documents, and performing compliance testing.

Your plan may pay separate fees for trust and/or custodial services. In many cases, however, these services are bundled with the recordkeeping and the costs are included in the recordkeeper’s fee.

The "Big Three" Retirement Plan Fees	What it is/What it Covers	How to Keep it in Check
Asset Management	• Largest single cost to a retirement plan • Expressed in the form of expense ratios for each investment option utilized within the plan	• Carefully consider selection of investment share classes • Eliminate revenue sharing when possible
Recordkeeping, Trust and Custodial	• Third party provider(s) that perform critical administrative, compliance, and maintenance of a plan	• Negotiate an independent fee for services to improve transparency • Consider a fixed-dollar fee based on the number of participant accounts
Investment Advisor and Plan Participant Education	• Assist plan sponsors with plan oversight and investment selection • Educate plan participants to promote increased utilization of the plan	• Negotiate a fixed-dollar fee arrangement (rather than asset-based)

How to Keep Recordkeeping Fees In Check

Historically, recordkeepers' compensation was derived from a combination of asset management fees, revenue sharing, and direct participant charges for transactions such as loans or distributions. Consequently, much of their compensation lacked transparency.

Eliminating revenue sharing from the investment options within the plan will require you to negotiate an independent fee for the recordkeeping and trust/custodial services. It's often best to separate these fees from the plan's assets. Consider a fixed-dollar fee based on the number of participant accounts within the plan. This fee arrangement, a per participant fee, will only vary as the number of plan participants changes, aligning costs more closely to the services provided.

When discussing the fee arrangement, inquire about other sources of revenue your recordkeeping partner may receive based on your plan. Additional compensation could include shareholder servicing fees (negotiated between the recordkeeper and investment managers) and platform or shelf-space fees (for including specific investment managers within their platform). As a plan sponsor, you should be aware of any direct or indirect revenue created by your plan.

3) Investment Advisor and Plan Participant Financial Education

Retirement plan investment advisors help plan sponsors with the plan oversight process. The advisor assists the plan sponsor with the selection and monitoring of investments offered in the plan. Additionally, the advisor, when serving as a fiduciary, shares some of the risks associated with offering an ERISA plan.

Financial education to plan participants ensures they are well-positioned to maximize the retirement plan. Oftentimes advisors are utilized in this role for plan sponsors, providing financial education about the plan and assisting participants with decisions about investments, contributions, and distributions.

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How to Keep Advisor Fees In Check

Similar to recordkeepers, advisors were often compensated via the annual stream of revenue sharing generated by the plan's assets. As plan assets rose, so did the advisor's compensation.

Now, more commonly, advisor fees are kept in check through fixed-dollar fee arrangements. Instead of automatic pay raises, advisor compensation is leveled. If your advisory services do not have this fixed structure, now is the time to renegotiate or go to market.

Plan Cost Review Considerations

Understanding the major cost components of your retirement plan is a first and important step toward clearly defined retirement plan fees. As your plan oversight group reviews these major cost components, consider the following:

- *Are we utilizing the optimal share class for each of the investment options offered in our plan?*
- *Do we understand the amounts and the distribution of the revenue sharing dollars generated within our plan?*
- *How is our recordkeeper being compensated? Do we clearly understand the amount of their annual compensation and is their compensation appropriate?*
- *How is our investment advisor compensated? Can we clearly delineate their compensation on an annual basis?*

As an ERISA plan fiduciary, your responsibility is to demonstrate the plan's fees are reasonable and that a prudent process for monitoring these fees is in place. Ensure your oversight group understands and accurately interprets the fees you are paying.

PART TWO: HOW TO PAY RETIREMENT PLAN FEES

Once you understand the fees that exist in your retirement plan, your oversight group must determine how these fees will be paid.

Payment Options and Definitions

Plan sponsors have primarily two options for paying the costs associated with the retirement plan :

1. Pay all or some of the plan costs from within the retirement plan itself
2. Pay all or some of the plan costs from the organization's assets

The types of costs associated with the performance of certain plan-related duties or functions is the first criteria in determining how these costs can be paid. ERISA has categorized plan-related duties into two categories – settlor and fiduciary.

Settlor Duties – Settlor duties describe certain plan-related decisions that have a material cost impact to the organization. Examples include establishing or terminating the plan, determining the level of company contributions, approving the adoption of the plan by entities acquired by the organization, and reviewing plan amendments. The costs incurred for these decisions are not eligible plan expenses. They must be paid from the organization's assets rather than from the plan.

Fiduciary Duties – Fiduciary duties describe tasks and costs incurred to set-up and administer a retirement plan. These costs are eligible plan expenses. Thus, the organization has discretion in how these costs are paid. The determinations may be influenced by your organization's benefits philosophy or tax planning strategy.

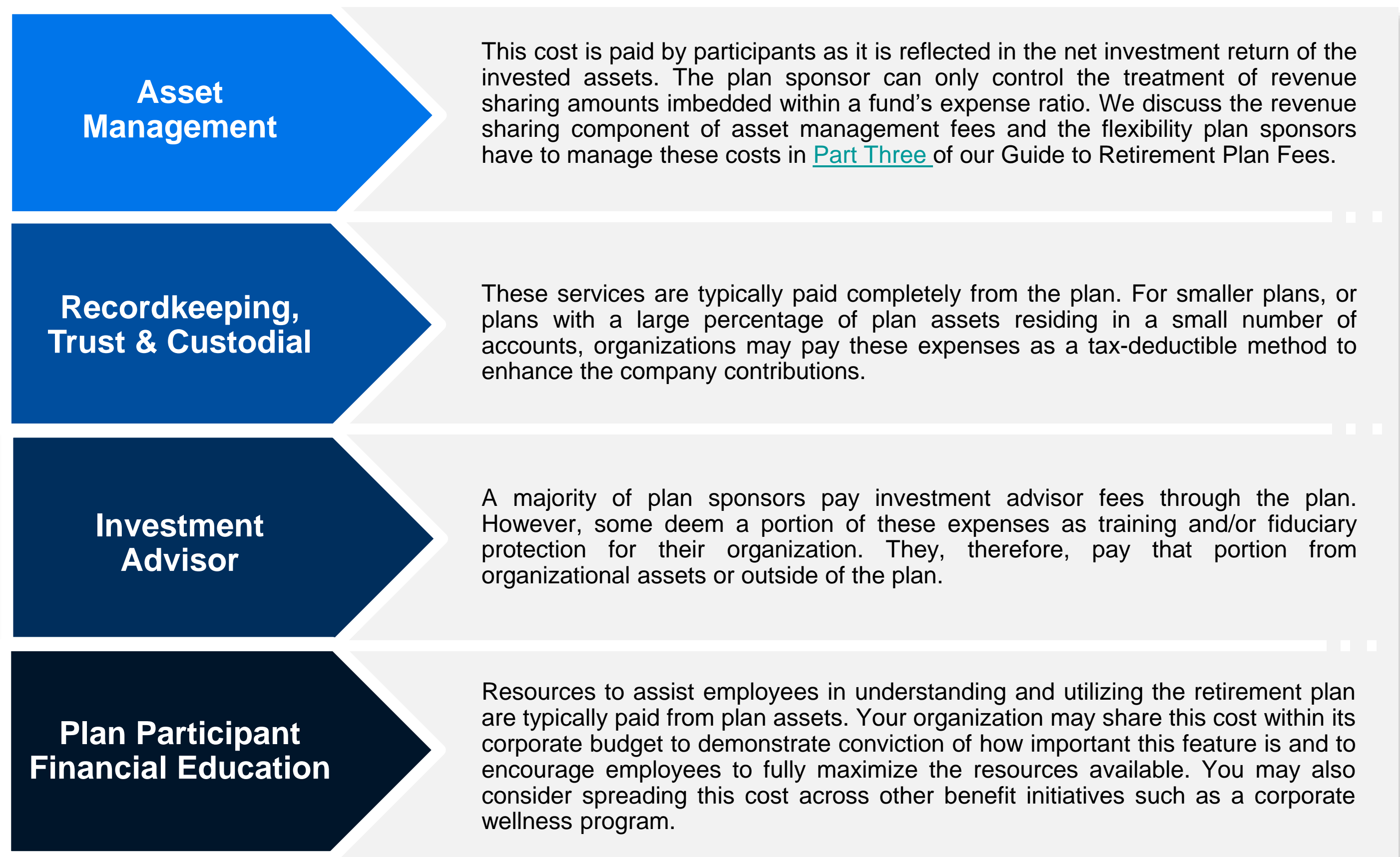
Retirement Plan Fee Payment Trends

Nationally, partially due to the invention of "bundled" plan service providers, the vast majority of organizations (70%+) pass through nearly all plan administrative costs to the plans themselves.

Some plan sponsors, however, choose to pay administrative costs from organization assets. Reasons plan sponsors cite include generating good will amongst plan participants or increasing the organization's contributions to participants in the form of lower plan expenses being deducted from their accounts. When plan participants pay lower fees, more money is there for their long-term savings.

Payment Considerations

Your plan oversight group may struggle in determining which payment option is best. Consider the following industry trends for handling each major cost component:



Asset Management	This cost is paid by participants as it is reflected in the net investment return of the invested assets. The plan sponsor can only control the treatment of revenue sharing amounts imbedded within a fund's expense ratio. We discuss the revenue sharing component of asset management fees and the flexibility plan sponsors have to manage these costs in Part Three of our Guide to Retirement Plan Fees.
Recordkeeping, Trust & Custodial	These services are typically paid completely from the plan. For smaller plans, or plans with a large percentage of plan assets residing in a small number of accounts, organizations may pay these expenses as a tax-deductible method to enhance the company contributions.
Investment Advisor	A majority of plan sponsors pay investment advisor fees through the plan. However, some deem a portion of these expenses as training and/or fiduciary protection for their organization. They, therefore, pay that portion from organizational assets or outside of the plan.
Plan Participant Financial Education	Resources to assist employees in understanding and utilizing the retirement plan are typically paid from plan assets. Your organization may share this cost within its corporate budget to demonstrate conviction of how important this feature is and to encourage employees to fully maximize the resources available. You may also consider spreading this cost across other benefit initiatives such as a corporate wellness program.

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Next Steps for Paying Retirement Plan Fees

Plan sponsors have flexibility in determining how the costs associated with their retirement plans will be paid. As your plan oversight committee makes these determinations, consider taking the following steps:

- ***Review the plan adoption*** *agreement to ensure it allows you to allocate plan costs in the manor you have determined is most suitable for your organization. If necessary amend your plan documents to agree with your payment practices.*
- ***Establish an organizational philosophy*** *for the handling of various plan expenses. You should consider the consistency and messaging of your philosophy related to the retirement plan relative to the other employee benefits.*
- ***Document your decision-making process*** *and the allocation methodology (charge to the plan or pay from organizational assets) you plan to adopt.*

Make sure your oversight group develops a strategy for the treatment of plan expenses that addresses the individual cost components of your plan.

PART THREE: PLAN PARTICIPANT COST ALLOCATION STRATEGIES

You know what costs you can expect to incur through your retirement plan and what options you have in paying those costs. Now, you need to develop a strategy addressing how the costs you've elected to pay from the plans' assets are charged to plan participants. Here we will dive into cost allocation strategies, outlining how to equitably distribute costs across plan participants.

Pro-Rata Allocation

Historically, costs charged to the retirement plan were allocated across participant accounts based on their account size. The total costs to recover were divided by the total plan assets, and this was applied to each participant's account. This process is referred to as a pro-rata allocation. It results in the larger account balances paying a disproportionate share of the fees in terms of dollars. Small account holders incur little in fees while large account holders effectively subsidize the costs of those smaller account balance participants.

Per Participant Allocation

An alternative to pro-rata allocation is a fixed, per participant charge. Costs are divided equally, and every participant pays the same fee. With this allocation model, however, low balance accounts pay a meaningfully larger percentage of their balance, hindering the growth of their accounts. Employers see this as a disincentive to participation and seek an alternative.

Most Equitable: Bifurcated Cost Allocation

Acknowledging the concerns with straight pro-rata or per participant cost allocation, a reformed process developed. This strategy follows a bifurcated – or "split" – methodology. A fixed, per participant fee is assessed annually to every participant, regardless of account balance. On average, this fee ranges from $40-$100 per year. The remaining expenses to recover are allocated on a pro-rata basis according to account balance.

The advantage of this “split” cost allocation methodology is transparency. All plan participants incur a base cost for participation (the per participant fee) and incur increasing fees as their account balance grows (the pro-rata fee). This is the most equitable method to recover plan expenses.

What about revenue sharing?

As described in Part One of our Guide to Retirement Plan Fees, the expense ratios for plan investments often conceal an additional cost for other plan service providers referred to as revenue sharing.

The amount of revenue sharing will vary based on what investments a plan participant selects. While we recommend plan sponsors eliminate revenue sharing whenever possible, that which remains can be incorporated into your cost allocation methodology.

You may consider using the revenue sharing to reduce the administrative fees collected through your allocation methodology. The flaw with this approach, however, is that it places an increased share of the administrative fee burden on the participants who invested in funds that pay revenue sharing. Therefore, we believe the best approach is to instruct your recordkeepering partner to return the revenue sharing payments directly to the participant accounts that invested in the funds which created the revenue.

Last, but Not Least: Participant Communication

No matter what cost allocation method your plan oversight group develops, your plan participants should be able to see and understand their cost for participating in the plan. Concisely communicate the cost allocation method you settle on and show participants how they can calculate their individual cost of participation. In the best case scenario, their participation cost should not change based on how they invest. Communication regarding cost could be delivered in the form of a presentation, video, or worksheet.

Questions to Consider regarding Fee Allocation Methodology

Understanding the fees incurred, paid, and allocated by your retirement plan is not a one-time practice. As a plan sponsor and fiduciary, you have the responsibility to monitor plan fees on an ongoing basis. As you consider your fee allocation methodology, prompt your plan oversight group with the following questions:

- *When was the last time we discussed how our retirement plan costs are allocated to plan participants?*
- *Can we demonstrate the existing allocation methodology follows a diligent and documented process?*
- *If a plan participant questions the fees paid, are we prepared to clearly outline the process we have in place to monitor and benchmark our plan’s fees?*
- *Are we effectively communicating this information to our participants?*

Demonstrating a prudent process exists for monitoring and allocating costs to plan participants will not exempt you from an ERISA claim, but you will be positioned to deliver a strong defense.

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Joe leads Francis Investment Counsel's business development efforts. He has over 30 years of progressive financial management experience. Joe previously served as Chief Financial Officer of a Wisconsin printing operation which allows him to bring a valuable plan sponsor perspective to his business development efforts. A Certified Public Accountant since 1985, Joe is currently a member of the Wisconsin Institute of Certified Public Accountants and a contributing writer for the Wisconsin CPA monthly journal. He is an active member of Metro Milwaukee Society for Human Resource Management (MMSHRM) and served on the Board of Directors of Wisconsin Retirement Plan Professionals, Ltd. (WRPPL). Joe is a graduate of Marquette University with a Bachelor of Science degree in Accounting.

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About Francis Investment Counsel

Francis Investment Counsel is an expert adviser to the qualified plan marketplace. Established in 2004, the Firm provides independent, conflict-free investment consulting, fiduciary training, and financial wellness services to retirement plan sponsors and their participants. With no products to sell, or retail wealth management business to support, Francis Investment Counsel is uniquely positioned to connect plan sponsors and their employees to fiduciary advice they can trust. Learn more by calling 866-232-6457 or visiting francisinvco.com

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