
Desperately
Seeking Revenue

## Retirement plan recordkeeping may get more expensive in 2022.

By Joseph Topp, CPA

If your retirement plan recordkeeper wasn't acquired within the past few years, don't be surprised if it happens in 2022. The frenzied M&A activity across corporate America has been particularly evident in the retirement plan recordkeeping industry, and industry observers predict continued consolidation in the years ahead. The reasons industry stalwarts like Prudential, Wells Fargo (Wachovia) and Mass Mutual have exited the recordkeeping business are many, but a primary contributor has been the intense fee compression seen by the industry over the past decade. The organizations that remain are desperately seeking alternative revenue sources, leaving plan sponsors with several new concerns.

Emboldened by the proliferation of Employee Retirement Income Security Act (ERISA) class-action lawsuits, plan sponsors have had great leverage to reduce the base recordkeeping costs of their plans. As recordkeepers look for alternative sources of revenue, their focus has turned to plan participants. A cautionary reminder for all plan sponsors: ERISA clearly mandates that plan fiduciaries must act in the sole interest of their participants and, therefore, are duty-bound to understand and monitor all revenue sources their plan administrative service provider avails itself of.

### Revenue sources from participants

In addition to the base plan administrative fees, which most plan sponsors have paid from participant accounts, participants are also assessed transaction fees based on individual activity within the plan. Initiation of a loan and a corresponding annual maintenance fee, processing any form of distribution and splitting accounts as the result of a qualified domestic relations order (QDRO) are all examples of fee-generating activities charged by the recordkeeper on top of the negotiated base administrative fees charged to the plan. These fees have seen upward pressure recently and will continue to be eyed by the recordkeepers, as most plan sponsors review only individual transaction fee amounts and

not the aggregate annual revenue the collective fees generate. We advise clients to track the aggregate amount and weigh it when evaluating the plan's total cost competitiveness in the current market.

### Managed account services

The fastest-growing trend we are seeing is a push by recordkeepers to add a managed account service to the plan features. A managed account entails a plan participant turning over full discretion for the investment and asset allocation of their accounts. The service comes with an ongoing fee that ranges from 20 to 50 basis points (0.20% – 0.50%). This fee is applied to the entire account balance, so for a participant with a balance of $129,000,[1] utilization of this service would cost between $258 and $645 per year. At first glance, this fee may not appear meaningful, but remember, this fee is in addition to embedded investment manager fees (fund expense ratios), the base annual recordkeeping fee and participant transaction fees. The recordkeepers' hard push for the managed account service is positioned as their response to participant requests for more help managing their retirement savings and serves as a solution for plan sponsors who do not have a well-developed strategy to provide participants with ongoing general education or opportunities to receive individual help in managing this aspect of their financial situation. The revenue potential is elevated by a

[1] Vanguard's How America Saves 2021 report average participant account balance

strong push from recordkeepers to make the managed account service the qualified default investment alternative (QDIA) offered by the plan, often replacing a target retirement date solution. Across our client base, for plans with assets between $20 and $100 million, the average investment management expense is 0.55%. The addition of a managed account service significantly increases the overall cost to the participant, and most managed account services we've evaluated have little or no track record that suggests superior investment returns.

## Cross-selling services to participants

One of the greatest attractions for an organization to provide recordkeeping services to a participant-directed retirement plan is the proximity it affords to the individual plan participants, who represent potential retail clients for the organization. In performing their services, recordkeepers have access to a tremendous amount of information on individual plan participants: age, job title, income, account balance and outside financial information. This information is willingly provided by participants who contact the call center, complete retirement readiness calculators or utilize the account aggregation tools. Margins on retail services tend to be meaningfully higher than those on retirement plan administration, so the temptation to aggressively pursue these opportunities is difficult to ignore, particularly in a period of aggressive fee compression. Access to and use of valuable participant information has become the subject of ERISA litigation. In 2019, Vanderbilt University settled a class-action suit involving their two 403(b) plans. One of the complaints listed was the university's plan fiduciaries allowing one of the plan's recordkeepers to use participant data to cross-sell services outside the plan. As part of the settlement agreement, Vanderbilt agreed to explicitly prohibit all future service providers from using participant personal data to promote services and products outside the plan.

## Plan sponsor action steps

As fiduciary to your organization's plan, your primary responsibility is to the participants. Diligence over plan assets and recordkeeping fees extends well past simply benchmarking the recordkeeping base fee to the organization and must include an understanding of all revenue generated by your service providers resulting from their affiliation with your organization. If you are utilizing or considering a managed account service, you have the dual task of evaluating the service's investment performance and measuring the fee revenue generated from plan participants. Diligent fiduciaries will also closely review their services agreement for language allowing the recordkeeper to directly use or share participant personal information across their organization for retail purposes. Plan sponsors uncomfortable allowing these practices have successfully negotiated with their providers to end unwanted conduct and amend the contract accordingly. Knowing that participants often use other services and products offered by plan recordkeepers, you should request information on the scope of these activities and any revenue generated. All of these revenue sources should be evaluated in aggregate when determining whether your retirement plan's fees are reasonable and competitive in today's marketplace.

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