How Do I Pay Thee? Let Me Count the Ways.

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by Portico Wealth Advisors

Retirement plans, like 401(k)s, 403(b)s, 457(b)s, etc., require the services of multiple providers to remain in good standing with the IRS and the Department of Labor (DOL). Chief among those services are administration, recordkeeping, investment advice, and custody. Each is provided in exchange for a fee, and it is the employer's ongoing responsibility to ensure that these fees are reasonable.

On the surface, it sounds fairly easy. Employers simply need to answer these three questions:

1. What services are required for my plan?
2. What am I paying for said services?
3. Are those fees reasonable?

However, the vast majority of plan sponsors are hard-pressed to answer these three questions at all, let alone accurately.

There are two primary reasons that sponsors find it difficult to articulate the reasonability of plan-level fees. First, sponsors are not devoting enough time to monitoring them. As fiduciaries, sponsors are required to make their retirement plans an ongoing priority. More often than not, however, plans are an afterthought. Sponsors are not meeting regularly to review fees, and when they are, the appropriate processes and procedures to ensure continued fiduciary compliance are not being followed.

The second reason that sponsors are often tongue tied when it comes to explaining fees is the lack of transparency throughout the retirement plan industry. Over the years, plans have been provided in many different formats by myriad vendors, including insurance companies, mutual fund companies, broker/dealers, and independent advisors. Each of these vendors has developed a different way of charging for the same set of services, making it exceedingly difficult for sponsors to compare one platform versus the next. Compounding matters further is that many of the fees for services are hidden from sponsors and their participants.

According to Marcia Wagner, of the Wagner Group in Boston, there are up to 8 different types of hidden fees in retirement plans:

1. SEC Rule 28(e) Soft Dollars—an extra fee charged by certain providers that can be used to procure additional plan-level or investment-specific research
2. Sub-Transfer Agent or "Sub-TA" Fees—a fee resulting from the outsourcing of certain administrative functions by the primary platform provider
3. Section 12-b-1 Fees—marketing or advertising fees that are usually paid as a commission to the broker that has installed the plan
4. Variable Annuity Wrap Fees—an additional fee that is "wrapped" around the underlying investment fees and may include insurance and surrender charges
5. Investment Management Fees—the fees for managing the underlying investments, e.g. the operating expense of a particular mutual fund
6. Sales Charges—also known as loads or commissions, these are enhanced charges for buying and selling investments within the plan
7. Revenue Sharing Arrangements—similar to Sub-Transfer fees, revenue sharing is another way for platform providers to pay other vendors for outsourced plan services
8. Float—the difference between the rate received by a platform provider for holding short-term cash investments and the rate credited to the plan

With all of these methods for hiding fees, it is no wonder that plan sponsors struggle to understand the true cost of their plan.

The DOL has recognized this challenge, and recently responded with its 408(b)2 regulation. This ruling, which takes effect in January 2012, will require all plan service providers receiving greater than $1,000/yr. from a plan to disclose that compensation. Providers will also be required to itemize the services rendered for those fees.

Although 408(b)2 is viewed as an important first step towards increased fee transparency in the industry, it also magnifies the ongoing fiduciary responsibilities of plan sponsors. More than ever before, sponsors will need to meet regularly to review their plan expenses, i.e. the 408(b)2 disclosures, and have a defined set of processes in place for measuring their reasonability.

One simple way for plan sponsors to fulfill their fiduciary duty is to procure an independent evaluation of their plan from a third-party. At Portico, we review 401(k), 403(b), and 457(b) plans regularly. Our complimentary Retirement Plan Diagnostic touches on over 100 points within the plan, including a thorough identification of all of fees. After completing a diagnostic, plan sponsors can feel confident that the plan they are providing is the best it can be in terms of cost, quality and structure.