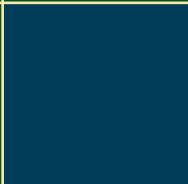
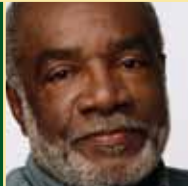
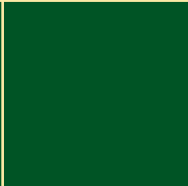
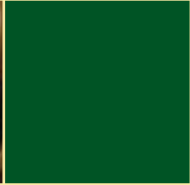
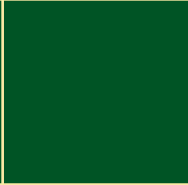
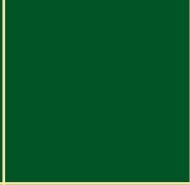
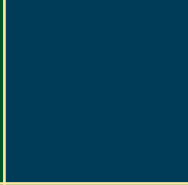
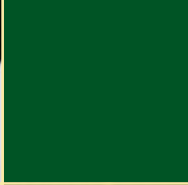


# UNDERSTANDING RETIREMENT PLAN FEES AND EXPENSES



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This booklet constitutes a small entity compliance guide for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.







## UNDERSTANDING RETIREMENT PLAN FEES AND EXPENSES

As the sponsor of a retirement plan, you are helping your employees achieve a secure financial future. Sponsoring a plan, however, also means that you, or someone you appoint, will be responsible for making important decisions about the plan's management. Your decisionmaking will include selecting plan investments or investment options and plan service providers. Many of your decisions will require you to understand and evaluate the costs to the plan.

The Federal law governing private-sector retirement plans, the Employee Retirement Income Security Act (ERISA), requires that those responsible for managing retirement plans — referred to as fiduciaries — carry out their responsibilities prudently and solely in the interest of the plan's participants and beneficiaries. Among other duties, fiduciaries have a responsibility to ensure that the services provided to their plan are necessary and that the cost of those services is reasonable.

This booklet will help you better understand and evaluate your plan's fees and expenses. While the focus is on fees and expenses involved with 401(k) plans, many of the principles discussed in the booklet also will have application to all types of retirement plans.

Remember, however, that this booklet provides a simplified explanation of plan and investment fees. It is not a legal interpretation of ERISA or other laws, nor is it intended to be a substitute for the advice of a retirement plan or investment professional.



## WHY CONSIDER FEES?

Plan fees and expenses are important considerations for all types of retirement plans. As a plan fiduciary, you have an obligation under ERISA to prudently select and monitor plan investments, investment options made available to the plan's participants and beneficiaries, and the persons providing services to your plan. Understanding and evaluating plan fees and expenses associated with plan investments, investment options, and services are an important part of a fiduciary's responsibility. This responsibility is ongoing. After careful evaluation during the initial selection, you will want to monitor plan fees and expenses to determine whether they continue to be reasonable in light of the services provided.

There has been a dramatic increase in the number of investment options, as well as level and types of services, offered to and by plans in which participants have individual accounts. In determining the number of investment options and the level and type of services for your plan, it is important to understand the fees and expenses for the services you decide to offer. The cumulative effect of fees and expenses on retirement savings can be substantial.

When plans allow participants to direct their investments, fiduciaries need to take steps to regularly make participants aware of their rights and responsibilities under the plan related to directing their investments. This includes providing plan and investment related information, including information about fees and expenses, that participants need to make informed decisions about the management of their individual accounts. Participants must receive the information before they can first direct their investments in the plan and annually thereafter.


## WHAT ARE THE TYPES OF PLAN FEES AND WHO PAYS FOR THEM?

There are a variety of plan fees and expenses that may affect your retirement plan. The following is an overview of some of those fees and expenses and the different ways in which they may be charged.

**Plan fees and expenses generally fall into three categories:**

**Plan administration fees.** The day-to-day operation of a plan involves expenses for basic administrative services — such as plan recordkeeping, accounting, legal and trustee services — that are necessary for administering the plan as a whole. In addition, a profit sharing or 401(k) plan also may offer a host of additional services, such as telephone voice response systems, access to a customer service representative, educational seminars, retirement planning software, investment advice, electronic access to plan information, daily valuation, and online transactions.

In some instances, the costs of administrative services will be covered by investment fees that are deducted directly from investment returns. In other instances, when the administrative costs are billed separately, they may be borne, in whole or in part, by the employer or charged directly against the assets of the plan. In the case of a 401(k), profit sharing, or other similar plans with individual accounts, administrative fees are either allocated among individual accounts in proportion to each account balance (i.e., participants with larger account balances pay more of the allocated expenses (a “pro rata” charge)) or passed through as a flat fee against each participant’s account (a “per capita” charge). Generally the more services provided, the higher the fees.



**Investment fees.** By far the largest component of plan fees and expenses is associated with managing plan investments. Fees for investment management and other related services generally are assessed as a percentage of assets invested. Employers should pay attention to these fees. They are paid in the form of an indirect charge against the participant's account or the plan because they are deducted directly from investment returns. Net total return is the return after these fees have been deducted. For this reason, these fees, which are not specifically identified on statements of investments, may not be immediately apparent to employers. *(See pages 5-9 for more information on investment-related fees.)*


**Individual service fees.** In addition to overall administrative expenses, there may be individual service fees associated with optional features offered under an individual account plan. Individual service fees may be charged separately to the accounts of those who choose to take advantage of a particular plan feature. For example, fees may be charged to a participant for taking a loan from the plan or for executing participant investment directions.

**Plan administrative and investment services may be provided through a variety of arrangements:**

Some or all of the various plan services and investment alternatives may be offered by one provider for a single fee paid to that provider (sometimes referred to as a bundled arrangement). The provider will then pay, out of that fee, any other service providers that it may have contracted to provide the services.

In other cases, plans may obtain services and investments from a variety of providers (sometimes referred to as an unbundled arrangement). The





expenses of each provider (e.g., investment manager, trustee, recordkeeper, communications firm) are charged separately.


Plans also may use an arrangement that combines a single provider for certain services, such as administrative services, with a number of different providers for investments.

Fees need to be evaluated keeping in mind the cost of all covered services.

## WHAT FEES ARE ASSOCIATED WITH THE INVESTMENT CHOICES IN MY RETIREMENT PLAN?

Apart from fees charged for administering the plan itself, there are two basic types of fees that may be charged in connection with plan investments or investment options made available to participants and beneficiaries. These fees, which can be referred to by different terms, include:

- **Sales charges** (also known as **loads** or **commissions**). These are basically transaction costs for buying and selling shares. They may be computed in different ways, depending on the particular investment product.
- **Management fees** (also known as **investment advisory fees** or **account maintenance fees**). These are ongoing charges for managing the assets of the investment fund. They are generally stated as a percentage of the amount of assets invested in the fund. Sometimes management fees may be used to cover administrative expenses. You should know that the level of management fees can vary widely, depending on the investment manager and the nature of the investment product. Investment



products that require significant management, research, and monitoring services generally will have higher fees. (See page 9.) Be aware that higher investment management fees do not necessarily mean better performance.

In addition, there are some fees that are unique to specific types of investments. Following are brief descriptions of some of the more common investments available to retirement plans and explanations of some of the different terminology or unique fees associated with them.

### **Some common investments and related fees:**

Most investments offered by smaller plans pool the money of a large number of individual investors. Pooling money makes it possible for smaller plans and participants in individual account plans to diversify investments, to benefit from economies of scale, and to lower their transaction costs. These pooled funds may invest in stocks, bonds, real estate, and other investments. Larger plans, by virtue of their size, are more likely to pool investments on their own — for example, by using a separate account held with a financial institution. Smaller plans generally invest in commingled pooled investment vehicles offered by financial institutions, such as banks, insurance companies, or mutual funds. Generally, investment-related fees, usually charged as a percentage of assets invested, are paid by the participant or the plan.

**Mutual funds.** Mutual funds pool and invest the money of many people. Each investor owns shares in the mutual fund that represent a part of the mutual fund's holdings. The portfolio of securities held by a mutual fund is managed by a professional investment adviser following a specific investment policy. In addition to investment management and administration fees, you may find these fees:


- Some mutual funds assess sales charges (see above for a discussion of sales charges). These charges may be paid when you invest in a fund (known as a **front-end load**) or when you sell shares (known as a **back-end load, deferred sales charge, or redemption fee**). A front-end load is deducted up front and, therefore, reduces the amount of your initial investment. A back-end load is paid when the shares are sold. A back-end load is determined by how long you keep your investment. There are various types of back-end loads, including some that decrease and eventually disappear over time.
- Mutual funds also may charge what are known as **12b-1 fees**, which are ongoing fees paid out of fund assets. 12b-1 fees may be used to pay commissions to brokers and other salespersons, to pay for advertising and other costs of promoting the fund to investors, and to pay various service providers to a plan pursuant to a bundled services arrangement.
- Some mutual funds may be advertised as “no load” funds. This can mean that there is no front- or back-end load. However, there may be a 12b-1 fee.

**Collective investment funds.** A collective investment fund is a trust fund managed by a bank or trust company that pools investments of retirement plans and other similar investors. Each investor has a proportionate interest in the trust fund assets. For example, if a collective investment fund holds \$10 million in assets and your investment in the fund is \$10,000, you have a 0.1 percent interest in the fund. Like mutual funds, collective investment funds may have a variety of investment objectives. There are no front- or back-end fees associated with a collective investment fund, but there are investment management and administrative fees.

**Variable annuities.** Insurance companies frequently offer a range of investment alternatives for individual account plans through a group variable annuity contract between an insurance company and an employer on behalf of a plan. Variable annuities include one or more insurance elements, which are not present in other investment alternatives. Generally, these elements include an annuity feature, interest and expense guarantees, and any death benefit provided during the term of the contract. The variable annuity contract “wraps” around investment alternatives, often a number of mutual funds. Participants select from among the investment alternatives offered, and the returns to their individual accounts vary with their choice of investments. In addition to investment management fees and administration fees, you may find these fees:

- **Insurance-related charges** are associated with investment alternatives that include an insurance component. They include items such as sales expenses, mortality risk charges, and the cost of issuing and administering contracts.
- **Surrender and transfer charges** are fees an insurance company may charge when an employer terminates a contract (in other words, withdraws the plan’s investment) before the term of the contract expires or when a participant withdraws an amount from the contract. These charges may be imposed if these events occur before the expiration of a stated period and commonly decrease and disappear over time. They are similar to an early withdrawal penalty on a bank certificate of deposit or a back-end load or redemption fee charged by some mutual funds.

**Pooled guaranteed investment contract (GIC) funds.** A common fixed income investment option, a pooled GIC fund generally includes a number of contracts issued by an insurance company or bank paying an interest rate



that blends the fixed interest rates of each of the GICs included in the pool. There are investment management and administrative fees associated with the pooled GIC fund.

While the investments described above are common, plans also may offer other investments that are not described here (such as employer securities).


### **WHAT OTHER FACTORS MIGHT HAVE AN IMPACT ON THE FEES AND EXPENSES OF MY RETIREMENT PLAN?**

Funds that are “actively managed” (i.e., funds with an investment adviser who actively researches, monitors, and trades the holdings of the fund to seek a higher return than the market as a whole) generally have higher fees than funds that are “passively managed” (see below). The higher fees are associated with the more active management provided and increased sales charges from the higher level of trading activity. While actively managed funds seek to provide higher returns than the market, neither active management nor higher fees necessarily guarantee higher returns.

Funds that are “passively managed” generally have lower management fees. Passively managed funds seek to obtain the investment results of an established market index, such as the Standard and Poor’s 500, by duplicating the holdings included in the index. Thus, passively managed funds require little research and less trading activity.


### **WHAT STEPS CAN I TAKE TO EVALUATE PLAN FEES AND EXPENSES?**

Fees and expenses are one of several factors to consider when you select and monitor plan service providers



and investments. The level and quality of service and investment risk and return will also affect your decisions.

- Begin by establishing an objective process to aid in your decisionmaking. This process should include an understanding of the fees and expenses you will pay and a review of those charges as they relate to the services to be provided and the investments you are considering.
- Before negotiating with prospective providers, think about the specific services you would like from a service provider (e.g., legal, accounting, trustee/custodian, recordkeeping, investment management, investment education or advice). Include the types and frequency of reports you wish to receive, communications to participants, meetings for participants, and the frequency of participant investment transfers.
- You will also need to consider the level of responsibility you want the prospective service provider to assume, the services that must be included in any retirement plan, the possible extras or customized services you wish to provide, and optional features, such as loans, Internet trading, and telephone transfers.
- Once you have a clear idea of your requirements, you are ready to begin receiving estimates from prospective providers. Give all of them complete and identical information about your plan and the features you want so that you can make a meaningful comparison. This information should include the number of plan participants and the amount of plan assets as of a specified date.
- For a service contract or arrangement to be reasonable, service providers must provide certain




information to you about the services they will provide to your plan and the compensation they will receive. This information will assist you in understanding the services, assessing the reasonableness of the compensation (direct and indirect), and determining any conflicts of interest that may impact the service provider's performance.

- Once you have selected a service provider or investments, be prepared to monitor the level and quality of the services and performance of investments to make sure they continue to be reasonable and they suit the needs of your employees. Make sure that you receive information on a regular basis so that you can monitor investment returns and service provider performance and, if necessary, make changes. Review any notices received from the service provider about possible changes to their compensation and the other information they provided when hired (or when the contract or arrangement was renewed).

By continuing to ask questions, you can make better decisions for your plan and your employees.

### **HOW DO I NEED TO PROVIDE FEE AND EXPENSE INFORMATION TO THE PARTICIPANTS IN MY PLAN?**

For plans that allow participants to direct the investments in their accounts, plan and investment information, including information about fees and expenses, must be provided to participants before they can first direct investments and periodically thereafter – primarily on an annual basis with information on fees and expenses actually paid provided at least quarterly. The initial plan related information may be distributed as part of the Summary Plan Description provided when a participant joins the plan as long as it is provided before the



participant can first direct investments. The information provided quarterly may be included with the Individual Benefit Statement.

The investment related information needs to be presented in a format, such as a chart, that allows for a comparison among the plan's investment options. A model chart is available on **[www.dol.gov/ebsa](http://www.dol.gov/ebsa)**. If you use information provided by a service provider that you rely on reasonably and in good faith, you will be protected from liability for the completeness and accuracy of the information.

## **IN CONCLUSION ...**

Fees and expenses are an important component in managing your retirement plan. For further information, you may want to consult the following resources at **[www.dol.gov/ebsa](http://www.dol.gov/ebsa)**:

- *Meeting Your Fiduciary Responsibilities*
- *Selecting an Auditor for Your Employee Benefit Plan*
- *Reporting and Disclosure Guide for Employee Benefit Plans*











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