

FEES FOR 401(K) SERVICES: WHAT PLAN SPONSORS NEED TO KNOW

Political candidates who don't know the cost of a gallon of gas or a movie ticket usually wind up paying that price with voters and losing on election day. Likewise, many plan sponsors are finding themselves on the losing side of lawsuits because they allowed their defined contribution plan to pay unreasonable service fees.

Plaintiffs' class action lawsuits against excessive fees dominated Employee Retirement Income Security Act (ERISA) litigation in 2017, according to Seyfarth Shaw's annual [Workplace Class Action Litigation Report](#). Of the \$2.72 billion spent by employers on the top 10 aggregate workplace class action settlements, nearly \$928 million came from the 10 largest ERISA settlements. That is up from \$807 million in 2016.

Seyfarth Shaw expects more of these lawsuits to come in 2018. That is bad news for many employers because defending and settling lawsuits can significantly affect an organization's bottom line. For example, in a case settled in May, plaintiffs alleged that Philips North America LLC paid too much for its investment management and administrative services. While the company said in court documents that it did nothing wrong, a U.S. District Court preliminarily approved a \$17 million payment to participants in its 401(k) plan.

In today's litigious environment, it's risky for plan sponsors be unaware of how much service providers are charging. Even successfully defending an allegation of paying excessive investment or administrative fees can be costly in terms of time, resources and money. We have found that many plan sponsors are calculating and analyzing their plan fees on a regular basis. As a result of those reviews, many are able to reduce service provider fees. Federal law binds plan sponsors with the duty of acting in the best interest of the participant, so it's imperative to understand the liability associated with not knowing the types of fees, how they can be charged and how to determine whether the payment is reasonable.

Knowing your Fees

While plans can have varying types of fees, the two largest are investment and administrative fees. The **investment fee** is typically the largest 401(k) service charge and is usually charged as a percentage of the assets invested. This fee, often referred to as the expense ratio, is what is paid to manage the investments offered in the 401(k) plan.

Another form of investment fees are 12b-1 or revenue sharing fees. These are charges from mutual funds for their marketing and other distribution materials. These fees were sanctioned in the 1980s as a way to bring investors to mutual funds to lower the overall cost of the investment. Often, this charge is rolled into the expense ratio of a 401(k) plan.

The **administrative fee** is what is paid to service providers to run the plan; record keepers, accountants and legal services fall under this umbrella. According to NEPC's [2017 Defined Contribution Plan and Fee Survey](#), 53 percent of plan sponsors pay a fixed fee per participant for record keeping services. This may be charged to plan participants directly or be covered by a portion of the fund expense ratio.

According to NEPC, the median plan record keeping fee for 2017 was \$59 per participant, compared to \$64 in 2015. The median investment fee ratio was 0.41 percent, compared to 0.46 in 2015.

It is important to note that as your plan grows in size, you have the ability to access lower cost class shares and effectively lower your annual expense ratio. When was the last time you revisited and renegotiated your plan fees with your service provider?

How Fees Affect Participants

According to a 2013 Department of Labor (DOL) paper on [401\(k\) fees](#), regardless of how the charges are paid, plan sponsors need to evaluate each arrangement on a regular basis. One of the reasons for this is because fees have a significant impact on the amount participants can save for retirement.

The DOL gave a simple example of an employee with 35 years left until retirement with \$25,000 in a current 401(k) account. Using an average 7 percent rate of return over 35 years, no annual contributions and an annual service fee of 0.5 percent, the employee's balance would grow to \$227,000 at retirement. Changing the fee to 1.5 percent under the same scenario would lower the final balance to \$163,000. So, a 1 percentage point difference in fees reduced the final account balance by 28 percent.

The important element to remember is that service providers need to give plan sponsors clear information on how much they are charging for services. The DOL instituted two rules in 2012 to help all parties understand how much is being charged and paid. The first rule instructs providers to give plan sponsors clear detail on their charges. The second requires plan sponsors to show participants how much they are paying for their 401(k).

Interestingly enough, even with this information, 37 percent of participants surveyed by [TD Ameritrade](#) earlier this year still think they don't pay any 401(k) plan fees.

Insight: Know Your Fees and Document Your Process

It's important for plan sponsors to remember that every service offered in a 401(k) plan has a cost. Education, online tools, investments, legal and other elements that providers might say are included or free all contribute to the overall cost. It's up to the plan sponsor to determine whether the overall fees are reasonable. In today's environment, plan sponsors who don't address these issues or don't conduct periodic reviews of service fees may likely find themselves in a very costly lawsuit.

There are plenty of benchmarking services available to plan sponsors to see how your plan stacks up with similar-sized plans or industry. Usually investment advisors help with this feature, but there are several online services that can help. [For Us All](#), a 401(k) advisory group, gives general guidance on investment fees, all-in bundled arrangements based on number of employees and other useful statistics. For example, For Us All uses data from other sources including the 401(k) Book of Averages to show that for a company with 50 to 199 employees, the national average expense ratio for funds is 1.09 percent.

There isn't a one-size-fits all solution for determining what's reasonable; what makes sense for one plan may not be appropriate for another. As a result, it's important for plan sponsors to document the process they use when choosing investments and service providers. Also, it's important to remember that reasonable doesn't always mean least expensive, nor does it suggest that higher fees generate better returns.

All of the components of a plan's decision-making process need to follow written policy statements. Having policy statements outlining the plan's purpose, the fiduciary obligations, selection process, how fees will be charged, paid and communicated, as well as other procedures, will help plan sponsors discharge their responsibilities more effectively.