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Retirement Fund Fees Squeezed By Disclosure Rules

By Elizabeth Ody and Margaret Collins - Thu Jan 05 05:01:01 GMT 2012

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Americans held about \$2.9 trillion in 401(k) accounts as of Sept. 30, according to the Investment Company Institute. Photographer: Derek Shapton

Chart: Fees in 401(k)-Type Plans

When Marc Spirn took a close look at retirement-plan costs at his Philadelphia-based medical office, they were so high he helped the business change 401(k) providers and save about \$30,000 a year.

“All of the partners in our practice were surprised with how much we were spending in revenue-sharing fees,” said Spirn, a physician who’s a retina specialist at Mid Atlantic Retina. “It wasn’t broken down well.”

U.S. Department of Labor rules requiring detailed disclosure of 401(k) expenses and revenue sharing are scheduled to take effect this year, making it easier for companies and their employees to see what they’re being charged. They may spur [small employers \(SBOIHIRE\)](#) and their workers, who generally pay higher fees for their plans than larger companies, to shop for better deals, and put pressure on providers such as mutual-fund firms and insurers to cut costs.

Some companies that offer 401(k) investment funds share fee revenue with firms that provide recordkeeping or brokers that sell [retirement plans](#). The amount flowing between funds and their service partners may be more than \$5 billion annually, according to BrightScope Inc., a San Diego-based firm that tracks 401(k) data. The Labor Department rules, which may still change, will give employers details on those transactions.

Americans held about [\\$2.9 trillion](#) in 401(k) accounts as of Sept. 30, according to the [Investment Company Institute](#). Workers pay an average of 91 percent of the costs associated with 401(k)-type plans, according to a November [report](#) by Deloitte LLP for ICI, the Washington-based trade group for the mutual- fund industry. The median fee was 0.78 percent of assets, or about \$248 per participant, the 2011 study said.

Lack of Knowledge

Spirn, 36, said his [medical practice](#) has about 200 employees and about \$8 million in 401(k) assets. By uncovering hidden charges and switching providers, Spirn said they were able to reduce revenue-sharing payments by an average of 44 basis points of fund assets. The partners also added more passively managed funds with lower expenses to the investment choices, he said. A basis point is 0.01 percentage point.

Most plan participants don’t realize they are absorbing the costs. About 71 percent of 401(k) savers said they thought they didn’t pay any fees and 6 percent said they weren’t sure, according to a [survey](#) released in March by [AARP](#), the Washington- based group of more than 37 million members that lobbies for the interests of Americans age 50 or older.

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"I have no idea what the fees are," said Alice Dickstein, who saves through a 401(k) account run by [Hartford Financial Services Group Inc. \(HIG\)](#) in [Connecticut](#). Dickstein is an [executive director](#) at a publishing company in New York and is thinking of retiring. She declined to give her age.

Dickstein said a friend, Walter Krocak, helps her track the [investments \(AMBTROI\)](#) because she doesn't have the time or interest to regularly review fees and statements.

"Companies that manage these things have to be paid something, but they don't spell it out," said Krocak, 66, an adjunct English professor at Westchester Community College in Valhalla, [New York](#). "It's hard to find out what they're getting and who it's coming from."

Employers are set to receive detailed disclosure on fees for [investment management](#), custody and administration by April, including revenue-sharing information, according to the Labor Department. [Workers](#) are due to receive additional disclosures later in the year, with specific dates depending on a plan's fiscal year.

Final Rule

The Labor Department hasn't issued final rules on disclosures to employers. The completed version could specify a format service providers must use in disclosures to employers, clarify how electronic disclosures may be used or change the effective date of the regulations, according to W. [Mark Smith](#), a partner with Sutherland Asbill & Brennan LLP in [Washington](#).

Some trade groups, including the Securities Industry and Financial Markets Association, which represents securities firms, banks and asset managers, and the American Society of Pension Professionals & Actuaries, have [asked](#) the Labor Department to push back the applicability dates of the regulations. Both groups submitted [letters](#) to the department in December saying more time will be needed to build any necessary infrastructure once a final rule is issued.

"Our new rules on fee disclosures, that will come into force in 2012, are meant to ensure that workers as well as employers and other plan sponsors get disclosures about retirement-plan fees and investment expenses that are clearer and easier to understand," Assistant Secretary of Labor Phyllis Borzi said in an e-mail yesterday.

Informed Choices

The rules will generally require employers to show employees the fees on each investment option per [\\$1,000](#) invested, such as \$10 for a fund with an expense ratio of 1 percent, so they can make comparisons and more informed choices, according to the Labor Department. Workers also will receive statements showing administrative costs charged to their individual accounts.

While employees will be told if their plan engages in revenue sharing, they generally won't receive details on the amounts paid or who it goes to, Smith said. Employers will see details on the arrangements, he said.

About 93 percent of firms offering investments to 401(k)- type plans pay revenue-sharing fees ranging from 10 basis points to 50 basis points to recordkeepers, according to Boston-based research firm Cerulli Associates. The practice can create conflicts of interest, according to a 2011 [report](#) by the Government Accountability Office. It may influence firms or individuals that sell the plans to steer employers toward investments with higher payments even if there are other choices with better performance or lower costs, said the GAO.

Impact on Accounts

"If the Department of Labor really wanted to make a difference, they should have attacked it by requiring the provider to give the participant and the employer the exact cost for all the different expenses," said Tom Gonnella, senior vice president of corporate development at Denver-based Lincoln Trust Co., which provides 401(k) administrative services. "It's not going to move

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Type	Today	1 Mo
30-Year Fixed	3.92%	3.98%
15-Year Fixed	3.25%	3.34%
5/1-Year ARM	2.86%	2.92%
3/1 Year ARM	2.78%	2.77%
1-Year ARM	2.75%	2.78%
30 Year Jumbo	4.86%	4.72%
15-Year Fixed Jumbo	4.15%	4.01%
5/1-Year ARM Jumbo	3.45%	3.15%

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Type	Today	1 Mo
30000 USD	6.70%	6.64%
Home Equity Loan	7.01%	7.47%
HELOC 30000 USD	5.56%	5.52%
HELOC Loan	3.95%	3.63%
Credit Union HELOC	4.30%	4.35%

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Type	Today	1 Mo
5-Year	1.58%	1.63%
2-Year	0.94%	0.95%
6-Month	0.52%	0.55%
1-Month	0.11%	0.11%
5-Year Jumbo	1.54%	1.54%
2-Year Jumbo	0.89%	0.87%
1-Year Jumbo	0.79%	0.78%
6-Month Jumbo	0.48%	0.47%
1-Month Jumbo	0.11%	0.11%

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Type	Today	1 Mo
New 36 Month	3.77%	3.77%
New 48 Month	3.89%	3.89%
New 60 Month	4.07%	4.07%
Used	4.48%	4.50%

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Type	Today	1 Mo
Standard Variable	13.94%	13.96%
Standard Fixed	14.43%	14.43%
Gold Variable	12.59%	12.68%
Gold Fixed	11.99%	11.99%
Platinum Variable	14.85%	14.75%
Platinum Fixed	13.53%	13.53%

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the needle like it needs to for participants.”

Revenue sharing could reduce an employee’s savings by more than \$30,000 over 25 years. Assuming a starting balance of \$50,000 with annual contributions of \$5,000, a participant earning 6 percent and paying 60 basis points in annual fees could accumulate about \$438,429. That compares with about \$407,953 for a saver who paid 1 percent in annual expenses, including 40 basis points in revenue-sharing charges.

The disclosure rules may result in pressure to lower fees as plan sponsors look at costs, said Jimmy Bhullar, an equity analyst at New York-based [JPMorgan Chase & Co. \(JPM\)](#) who covers insurers that provide 401(k) plans. More people in the plans may also consider passively managed funds, he said.

‘Wake-Up Moment’

The biggest changes may come at small companies that see expenses broken down for the first time, said Brian Graff, chief executive officer of Arlington, Virginia-based ASPPA, the pension-professionals group.

“It’s going to be a wake-up moment,” particularly for employers that haven’t been diligent about negotiating lower fees as account balances have increased over time, said [David Wray](#), president of Plan Sponsor Council of America in [Chicago](#), a nonprofit that represents employers with 401(k)s.

Companies with fewer employees and lower average 401(k) balances generally pay higher fees, as a percentage of assets, than larger ones, according to the study by Deloitte for ICI. The median cost of plans with less than \$1 million in assets was 1.41 percent, compared with 0.38 percent for those with more than \$1 billion, the report said.

Fidelity, Vanguard

Some mutual-fund companies also may pay a finder’s fee to brokers or other parties for bringing in new plan assets. In the new disclosure format, those payments generally will be disclosed to employers and won’t be detailed to savers, said Marcia Wagner, managing director of the Boston-based Wagner Law Group.

[Fidelity Investments](#) may pay a one-time finder’s fee of as much as 1 percent of assets invested in certain Fidelity Advisor mutual-fund share classes to brokers who sell employers a 401(k) that offers the funds, according to prospectuses. Fidelity doesn’t pay the fees with plan assets, said Stephen Austin, a spokesman for the Boston-based firm, which is the largest 401(k) provider, with almost 11.7 million participants.

Not all plans that use Fidelity work with a broker and the practice is more common among smaller plans, said [Beth McHugh](#), vice president of market insights for the company.

“Vanguard has already been providing much of the necessary information under the new regulations, so we see these changes as more of an evolution than a fundamental shift,” said [Linda Wolohan](#), spokeswoman for [Valley Forge](#), Pennsylvania-based Vanguard Group Inc. Vanguard is the third-largest recordkeeper of 401(k) plans, Cerulli data show.

Fee Reductions

Large companies that sponsor 401(k) plans have become more aware and proactive on fees in recent years, said Pamela Hess, director of retirement research for Aon Hewitt. The firm is the second-largest recordkeeper of 401(k) accounts, according to Cerulli, and is a unit of Chicago-based [Aon Corp. \(AON\)](#)

Some plans that have shopped around in the last year have been able to negotiate fee cuts of more than 50 percent, said Donald Stone, managing partner of Chicago-based Plan Sponsor Advisors, a consultant to employers offering retirement plans.

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“In every single case we’ve been able to negotiate substantial reductions,” he said.

Spirn, the physician, said the partners in his practice wanted to lower costs so they could have more saved at retirement.

“If we can reduce the fees the money will grow faster and more efficiently,” he said. “We’re hoping it makes a big difference.”

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