



Defined Contribution Recordkeeping Fees Models & Fee Benchmarking

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Agenda

- Definition of Terms
- Considerations
- Recordkeeping Fee Models in Defined Contribution Plans
- Fee Benchmarking in Defined Contribution Plans
- Share Class Analysis

Definition of Terms

- Revenue Sharing – A portion of the investment's expense ratio paid to the recordkeeper for shareholder services
- Asset Based Fee – A fee expressed as a percentage of assets assessed to all or some of the investments
- Revenue Credit Account – An account established within the Plan that receives money from the assets or vendor to be used for required or fiduciary expenses

Considerations

- Applicability of Employee Retirement Income Security Act (1974)
 - In plans subject to ERISA, the code prescribes the types of expenses may be charged to plan assets
 - Settlor vs Non-Settlor
 - Governmental plans generally have greater latitude in determining what types of expenses are allocable to plan assets
 - Subject to state or other federal laws
- Risks associated with plan expenses are almost exclusively oriented to those being charged (directly or indirectly) to client assets
 - Reasonableness of fees charged by vendors
 - Fairness in how fees are allocated
 - Impact of share class decisions on plan economics and participant expenses

Recordkeeping Fee Models

- Cost-Based
- Revenue Requirement
- Revenue Sharing (Target)
- Revenue Sharing Plus (Requirement + Target)
- Fund Level Equalization

Multnomah Group's Fee Benchmarking Report

Objective

- To clearly articulate the fees incurred for investment management and recordkeeping services to the plan
- To demonstrate the opportunity for price improvement of recordkeeping and administration services by benchmarking the plan against Multnomah Group's estimate of the market for plans with similar demographics
- To provide actionable information for the client to work with in evaluating the fees of their recordkeeping vendor(s)

What It Doesn't Do

- Summarize all plan fees (investment consulting, audit, legal, transactional fees)
- Audit historical fees charged by the vendor (fees are an estimate based on spot data for all pricing inputs)
- Identify to which party (participant or employer) fees are charged
- Benchmark investment management fees

Cost-Based Model

- Fee consists of a combination of base fee, per participant fee, and explicit asset based fee
- Fees are often aligned to the specific cost of services
 - Base Fee = Plan Document/Compliance Testing/5500 Preparation
 - Per Participant Fee = Communications/Web/Call Center/Mailings
 - Asset Based Fee = Custody
- The cost-based model is most typically found in unbundled recordkeeping relationships with local/regional TPAs and separate custodians
- The cost-based model is becoming more popular for plans with low turnover and high average account balances
- Revenue sharing is typically credited back either to plan participants or used to offset the explicit fees charged by the vendors

Cost-Based Model Example

Recordkeeping Fees

Plan Recordkeeping Fees

	Rate	Fees
Base Fee:	\$14,200.00	\$14,200.00
Participant Fees: (67 participants)	\$0.00	\$0.00
Asset Based Fees:	0.07%	\$4,851.24
Revenue Sharing:		\$0.00
Fund Level Wrap Fees:		\$0.00
Revenue Requirement:		\$0.00
Total Recordkeeping Fees (\$):		\$19,051.24
Total Recordkeeping Fees (%):		0.27%
Peer Group Range:		0.21%-0.30%

67 participants and \$103,437.96 average account balance

Transaction Fees

	Rate	Vendor Range
Distribution Fee:	\$80.00	\$0 - \$80
Loan Initiation Fee:	\$150.00	\$0 - \$150
Loan Maintenance Fee:	N/A	\$0 - \$50
QDRO Fee:	\$300.00	
Self-Directed Brokerage Account Fee:	N/A	\$0 - \$250

Base Fee + Participant Fees + Asset Based Fees = Total Recordkeeping Fees (\$)

Revenue Requirement Model

- Fees consist of a stated revenue requirement expressed as a % of plan assets that the vendor needs to collect
- Inclusive of administration, recordkeeping and participant services
- Vendor is indifferent as to payment method (revenue sharing or asset based charge)
- Fees are usually paid (at least partially) through revenue sharing payments from the funds
- The key differentiator for this model is that the vendor needs to periodically reconcile the revenue it receives against the stated revenue requirement
 - Excess revenue is credited back (to a revenue credit account or to participants)
 - A shortfall in revenue is closed with an explicit charge (usually an asset based charge paid by participants)

Revenue Requirement Model Example

Vendor

Recordkeeping Fees

Plan Recordkeeping Fees

	Rate	Fees
Base Fee:	\$0.00	\$0.00
Participant Fees: (1353 participants)	\$0.00	\$0.00
Asset Based Fees:	0.00%	\$0.00
Revenue Sharing:		\$0.00
Fund Level Wrap Fees:		\$0.00
Revenue Requirement:	0.160%	\$217,991.38
Total Recordkeeping Fees (\$):		\$217,991.38
Total Recordkeeping Fees (%):		0.16%
Peer Group Range:		0.10%-0.16%

1353 participants and \$100,698.16 average account balance

Transaction Fees

	Rate	Vendor Range
Distribution Fee:	N/A	\$0 - \$80
Loan Initiation Fee:	N/A	\$0 - \$150
Loan Maintenance Fee:	N/A	\$0 - \$50
QDRO Fee:	N/A	
Self-Directed Brokerage Account Fee:	N/A	\$0 - \$250

Note that our analysis ignores “how” they get to the revenue requirement. Fees may be paid from Plan Sponsor, Asset Based Fees, or Revenue Sharing

Revenue Sharing (Target) Model

- The vendor collects revenue sharing sufficient to subsidize their recordkeeping and administrative fees
- Frequently quoted as a revenue requirement during the sales process
- Does not include any periodic reconciliation of revenue relative to the quoted fee
 - No “excess” fees returned to participants
 - Can create a revenue credit account that is funded by a set amount annually
- The vendor takes the risk to collect the revenue from the investment managers
- Fund changes are most difficult because they have pricing impact
 - More vendor involvement is required
 - Limited universe of matching revenue sharing funds
 - May require changes in pricing model
- Periodic price reductions are done through the use of less expensive share classes
- Limits the investment universe to only revenue sharing funds
- Most common in small plans

Revenue Sharing (Target) Example

Vendor			Recordkeeping Fees		
Plan Recordkeeping Fees			Transaction Fees		
	Rate	Fees		Rate	Vendor Range
Base Fee:	\$0.00	\$0.00	Distribution Fee:	\$0.00	\$0 - \$80
Participant Fees: (1425 participants)	\$0.00	\$0.00	Loan Initiation Fee:	\$75.00	\$0 - \$150
Asset Based Fees:	0.00%	\$0.00	Loan Maintenance Fee:	\$25.00	\$0 - \$50
Revenue Sharing:		\$145,793.67	Self-Directed Brokerage Account Fee:	N/A	\$0 - \$250
Fund Level Wrap Fees:		\$0.00			
Revenue Requirement:		\$0.00			
Total Recordkeeping Fees (\$):		\$145,793.67			
Total Recordkeeping Fees (%):		0.19%			
Peer Group Range:		0.13% - 0.20%			
1425 participants and \$53,922.86 average account balance					

Revenue Sharing collected by vendor who assumes pricing risk

Revenue Sharing Plus (Require + Target) Model

- The vendor collects revenue sharing but it is insufficient to meet their total revenue needs
- In addition to revenue sharing, the vendor charges additional fees (base, per participant, and/or asset based fees)
- Implementation of this model takes many forms depending on the vendor.
- Provides greater investment flexibility than “Revenue Sharing Model”

Revenue Sharing Plus (Require + Target) Example

Vendor

Recordkeeping Fees

Plan Recordkeeping Fees

	Rate	Fees
Base Fee:	\$3,000.00	\$3,000.00
Participant Fees: (35 participants)	\$40.00	\$1,400.00
Asset Based Fees:	0.00%	\$0.00
Revenue Sharing:		\$7,451.86
Fund Level Wrap Fees:		\$0.00
Revenue Requirement:		\$0.00
Total Recordkeeping Fees (\$):		\$11,851.86
Total Recordkeeping Fees (%):		0.23%
Peer Group Range:		0.21%-0.30%

35 participants and \$146,819.13 average account balance

Transaction Fees

	Rate	Vendor Range
Distribution Fee:	\$0.00	\$0 - \$80
Loan Initiation Fee:	\$75.00	\$0 - \$150
Loan Maintenance Fee:	\$25.00	\$0 - \$50
QDRO Fee:	N/A	
Self-Directed Brokerage Account Fee:	N/A	\$0 - \$250

Base Fee + Participant Fees + Asset Based Fees + Revenue Sharing =
Total Recordkeeping Fees (\$)

Fund Level Equalization Model

- The vendor has a revenue requirement for the plan (stated as a % of plan assets)
- For each fund in the investment menu they determine the fund's revenue sharing
- The difference between the fund's revenue sharing and the revenue requirement is charged (or credited back) to participants in the fund
- Example

Fund	Plan Revenue Requirement	Revenue Sharing	Fund Level Wrap Fee
Fund A	0.16%	0.10%	0.06%
Fund B	0.16%	0.40%	-0.24%

- This method is the most difficult operationally because of the number of moving parts
- Creates challenges with participant communications

Fund Level Equalization Example

Vendor

Recordkeeping Fees

Plan Recordkeeping Fees

	Rate	Fees
Base Fee:	\$0.00	\$0.00
Participant Fees: (551 participants)	\$0.00	\$0.00
Asset Based Fees:	0.00%	\$0.00
Revenue Sharing:		\$4,295.78
Fund Level Wrap Fees:		\$24,072.09
Revenue Requirement:		\$0.00
Total Recordkeeping Fees (\$):		\$28,367.87
Total Recordkeeping Fees (%):		0.16%
Peer Group Range:		0.18% -0.38%

551 participants and \$31,685.78 average account balance

Transaction Fees

	Rate	Vendor Range
Distribution Fee:	N/A	\$0 - \$80
Loan Initiation Fee:	N/A	\$0 - \$150
Loan Maintenance Fee:	N/A	\$0 - \$50
QDRO Fee:	N/A	
Self-Directed Brokerage Account Fee:	N/A	\$0 - \$250

Investment Name	Assets	Revenue Sharing (%)	Revenue Sharing (\$)	Fund Level Wrap Fee (%)	Fund Level Wrap Fee (\$)
Causeway International Value Instl	\$306,531.26	0.10%	\$306.53	0.06%	\$183.92
ClearBridge Small Cap Growth IS	\$521,599.76	0.00%	\$0.00	0.16%	\$834.56
DFA Intl Small Company I	\$291,011.22	0.00%	\$0.00	0.16%	\$465.62
Harding Loevner Intl Equity Instl	\$284,323.90	0.15%	\$426.49	0.01%	\$28.43
Invesco Diversified Dividend R6	\$790,861.57	0.00%	\$0.00	0.16%	\$1,265.38
Northern Small Cap Value	\$425,852.67	0.40%	\$1,703.41	-0.24%	(\$1,022.05)
Prudential Total Return Bond Q	\$416,261.27	0.00%	\$0.00	0.16%	\$666.02
T. Rowe Price Blue Chip Growth	\$950,444.49	0.15%	\$1,425.67	0.01%	\$95.04
TIAA-CREF Social Choice Bond Instl	\$306,427.10	0.00%	\$0.00	0.16%	\$490.28
TIAA-CREF Social Choice Eq Instl	\$357,773.55	0.00%	\$0.00	0.16%	\$572.44
Vanguard Prime Money Market	\$155,083.71	0.00%	\$0.00	0.16%	\$248.13

Share Class Analysis

The purpose of the Share Class Analysis report is to demonstrate the complexity of the investment marketplace, educate clients on the difference in share class availability, and provide an introduction into the topic to determine whether additional analysis of share classes is needed.

As a secondary purpose, the Share Class Analysis report could be used to verify whether the Plan is currently using the least expensive (net of revenue sharing) available share classes, or if less expensive share classes may be available.

Fund	Share Class	Expense Ratio	Revenue Sharing	Net Expense Ratio	Asset Minimum
Vanguard Bond Market	Investor	0.20%	0.0%	0.20%	\$3,000
Vanguard Bond Market	Admiral	0.05%	0.0%	0.05%	\$10,000
Vanguard Bond Market	Institutional	0.04%	0.0%	0.04%	\$5,000,000
Vanguard Bond Market	Institutional Plus	0.02%	0.0%	0.02%	\$100,000,000

Share Class Considerations

- The client's fee model will dictate to what extent alternate share classes should be considered.
- Share class availability is dependent on the recordkeeper and investment manager
 - Newer R-6 share classes may not be set up by recordkeepers yet
 - Investment managers have different policies on investment minimums for retirement plan clients
 - The recordkeeper is the only one that can tell us whether the funds that *may be* available, are *actually* available for the client on their platform
- Our belief is that it is a best practice to separate investment management and recordkeeping fees by using institutionally-priced, zero revenue investment choices
 - Opportunities to arbitrage fees with higher expense ratio funds with lower net investment management fees will decline over time
- Look for opportunities beyond share class adjustments, particularly with index funds
 - An actively managed fund with an expense ratio of 0.16% and revenue sharing of 0.01% vs. an passively managed index fund with an expense ratio of 0.05%

Action Items

- Gather and read all service agreements to identify fees and associated services
- Obtain 408(b)(2) disclosures, but understand fees that are not charged to the Plan (e.g. paid by Plan Sponsor) may not be identified in the disclosure.
- Solicit feedback from those who operate the Plan and participants on satisfaction with vendor
- Consider whether unique Plan designs increase the cost of service
- Consider amount of onsite service received
- Compare fees and services to the available market place, not peers

Additional Resources

A Guide to Retirement Plan Fees and Expenses

www.multnomahgroup.com/a-guide-to-retirement-plan-fees-expenses

Defining Expense Accounts

<http://www.multnomahgroup.com/defining-expense-accounts>

FAQ: Fee Reasonableness

www.multnomahgroup.com/faq-fee-reasonableness

Trending Toward Fee Equalization

www.multnomahgroup.com/trending-toward-fee-equalization-white-paper

Conducting a Vendor Search: Benefits & Best Practices

www.multnomahgroup.com/conducting-a-vendor-search-benefits-and-best-practices

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