



Understanding Hidden Fees in Retirement Plans

Retirement plan fiduciaries have responsibility for identifying, understanding and evaluating fees and expenses associated with plan investments, investment options and the services provided by their providers. Fiduciaries should also monitor fees received by third parties that are paid from the cost structures of the investment vehicles and determine if they are “fair and reasonable.” Known in the industry as “revenue sharing,” these fees are, unfortunately, not clearly explained to plan sponsors and participants....they are “hidden.” These hidden fees are a target for abuse and can be very challenging for fiduciaries to manage.

After three decades of misuse...regulators, legislators and the media are finally catching on to the industry’s “revenue sharing” practices. All are paying close attention to these hidden fees or “soft dollars” and are focused on changing the practice and enhancing disclosure. Until changes are made, however, fiduciaries are being asked to identify and police the hidden fees that everyone has ignored for so long. Fair or not, predictably there is an increasing level of fee litigation occurring asserting a breach of fiduciary responsibility relating to plan fiduciaries’ lack of understanding fees and the unreasonableness of the fee levels.

There are three main types of “hidden fees” received by third parties:

Revenue Sharing Arrangements

This is the practice by mutual funds or other investment providers of paying other plan service providers (i.e., third party administrators and recordkeepers) for performing services that the mutual fund might otherwise be required to perform. The mutual fund has typically built into the cost of their fund charges (also known as expense ratios) fees for services they may not ultimately perform for a retirement plan. These fees are paid instead to your service provider. These fees are also called “sub-transfer agent / sub-TA fees” and “shareholder servicing fees.” The payment arrangement of these fees is legal. The issue, of course, is that they are typically hidden and not disclosed.

Fiduciaries must determine whether the fees being paid to their service providers from the mutual fund families (along with the fees being charged directly to the plan sponsor or participant) are reasonable for the services rendered.

12b-1 Fees

These are fees that are included in the fund charges / expense ratios of mutual funds for the promotion or distribution of the mutual fund. The idea is that investors are better off if the fund continues to grow in size as expenses can be shared. Its name is derived from the section in the regulation that permits the fee.

These fees are generally paid as commissions to brokers who service retirement plans. They may also be paid to non-investment professionals such as recordkeepers or insurance companies who offer them in their “wrap” programs. Most mutual funds have varying share classes that provide for higher and lower revenue from 12b-1 fees paid by the investors. Brokers and recordkeepers have an incentive to utilize funds that have 12b-1 fees or share classes that have higher 12b-1 fees as it increases their revenue streams. Fiduciaries have an obligation to understand what the broker or service provider is receiving and whether it is reasonable for the services provided.

Variable Annuity Wrap Fees

Insurance provider products typically have underlying mutual funds offered inside them. Variable annuity platforms not only have the expense ratio of the underlying mutual funds to contend with but a plan level “wrap charge” to cover the insurance components / services provided by the insurance company. When the expense ratio of the fund is added to the plan level “wrap charge” (which, of course, is not usually disclosed in a user-friendly format) the overall charge against plan assets is greater than the fees charged by a pure mutual fund based platform.

The “wrap charge” associated with a variable annuity product is not unacceptable as long as the total charge against plan assets is deemed to be “fair and reasonable” for services provided and other platforms have been considered. Fiduciaries are required to understand the total plan asset charges involved in a variable annuity platform and how those charges impact the plan and the participant’s retirement accumulation.