Retirement Plan Fees
Do You Understand Your Fees—And Are They Reasonable?

Part of your ERISA fiduciary duty as a retirement plan sponsor is to make sure that the services provided to the plan are necessary and the fees paid for these services are reasonable.

There has been a dramatic increase recently in the types of services offered to plan sponsors, as well as the number of investment options offered by plans to participants. This makes it more important than ever to understand all of the fees associated with your plan.

Three Main Fee Categories
Most fees and expenses associated with retirement plans fall into three broad categories:

1. Plan administrative fees: Retirement plans incur expenses for the basic administrative services that are required in day-to-day plan operations. These include accounting, legal, recordkeeping, and trustee services. Profit-sharing and 401(k) plans may also offer additional services such as investment advice, daily valuation, online transactions, educational seminars, and access to customer service reps.

These costs can be paid by fees deducted from investment returns or charged directly against plan assets. If the retirement plan features individual accounts, the fees are either allocated among the accounts in proportion to their balances or passed through as a flat fee against each account.

2. Individual service fees: These are associated with optional plan features and may be assessed on top of plan administrative fees. They are usually charged separately to the accounts of participants who use these plan features, like taking out plan loans or executing participant investment decisions.

3. Investment fees: These fees are assessed as a percentage of assets invested—they are by far the biggest component of managing plan investments. Investment fees are deducted from investment returns and paid in the form of an indirect charge against participant accounts or the plan itself, so you should pay especially close attention to them.

Plan investment fees, meanwhile, fall into one of two main categories:

1. Sales charges: Also referred to as sales loads or commissions, these are the transaction costs associated with buying and selling securities. Sales charges can be determined in different ways, depending on the specific type of investment.

2. Management fees: Also referred to as investment advisory or account maintenance fees, these are fees charged for managing fund assets.

Continued on page 3
When was the last time you closely examined your retirement plan’s internal controls? If you’re not sure, or if the answer is “a while ago,” then now is a good time to take a close look at these controls. Strong internal controls are essential not only to ensure that your retirement plan remains in compliance with all regulatory requirements and plan provisions, but also to guard against fraud. Additionally, they can help you maintain your plan’s tax-favored status, help make you eligible for the IRS’ Self-Correction Program, and limit the possibility that the IRS will perform an expanded audit on your plan.

**Steps to Follow**
The American Institute of Certified Public Accountants (AICPA) lists a number of steps plan sponsors should follow in the evaluation of a plan’s internal controls, including the following:

1. **Establish control objectives.** Internal control objectives might include things like making sure plan investments are measured at fair value and ensuring that participant contributions meet required amounts.

2. **Evaluate control risks.** You want to make sure that adequate internal controls are in place in the areas that pose the greatest risk for your plan.

3. **Use COSO.** The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control—Integrated Framework is widely recognized as a comprehensive framework for establishing appropriate internal controls.

4. **Communicate your controls.** Once established, document and communicate the internal controls to all employees who must follow them.

5. **Monitor your controls.** The design and operation of your plan’s internal controls should be monitored and reviewed on a periodic basis. You should check to make sure they are in place and operating as intended and that any problems or exceptions are identified and promptly resolved.

**Objectives and Internal Controls**
Following are examples of common objectives for retirement plan internal controls and the specific controls that can address them:

**Objective:** Ensuring that investment transactions are recorded accurately and on time

- **Internal controls:**
  - Timely review of reports submitted by trustees, asset custodians, and investment managers
  - Regular reconciliation of detailed subsidiary records to trust reports
  - Regular comparison of control totals from participant records to control totals from trust reports

**Objective:** Ensuring that investment transactions are initiated in accordance with established investment policies

- **Internal controls:**
  - Documentation of the investment criteria or objectives in the plan instrument or plan committee minutes
  - Authorization of the ability to execute transactions in the plan instrument or plan committee minutes
  - Review of investment transactions for adherence to investment guidelines by the investment committee

**Objective:** Ensuring protection of investment assets from loss or misappropriation

- **Internal controls:**
  - Segregation of responsibility for investment decisions and transactions from the custodian
  - Review of the financial stability of institutions holding participant investments
  - Control of documents in a limited access and fireproof area
  - Limiting access to investment records on a need-to-know basis

**It’s Your Responsibility**
As the plan sponsor, you are ultimately responsible for establishing and maintaining appropriate internal controls. Your auditor may be able to help you determine which controls are appropriate and necessary for your plan.

Please contact us if you have more questions about retirement plan internal controls.
Stated as a percentage of the total assets invested in the fund, these fees can vary considerably based on the investment manager and type of investment.

If participants are allowed to direct their own investments, you must provide information about investment fees and expenses to them before they begin directing investments. After this, you must provide the information on a periodic basis (such as quarterly or annually). The information must be presented in such a way that participants can make comparisons between investment options (such as in a chart).

**Fees Unique to Investments**

There are also some plan fees that are unique to certain kinds of investments. These may include the following:

- **Mutual fund fees**: Most mutual funds assess sales charges either when investors buy (front-end loads) or sell (back-end loads) shares, although some funds are no-load. In addition, mutual funds may assess 12b-1 fees to cover broker and salesperson commissions, advertising and promotional costs, and various service providers.

- **Collective investment funds**: These do not have front-end or back-end loads, but they do feature investment management and administrative fees.

- **Variable annuities**: These include one or more insurance elements—such as the annuity feature, interest and expense guarantees, and a death benefit—that make them unique among plan investments. Variable annuities may charge insurance-related fees, such as sales and mortality risk charges, and surrender and transfer fees if participants terminate insurance contracts before the term expires.

- **Pooled guaranteed investment contract (GIC) funds**: This fixed-income investment usually includes interest-paying contracts issued by a bank or insurance company. GIC funds usually charge administrative and investment management fees. It can be especially difficult to understand all of the fees associated with insurance contracts that are part of pooled separate accounts like GICs.

**Active vs. Passive Management**

Another factor to consider when evaluating investment fees is whether funds are actively or passively managed. Actively managed funds employ an investment advisor who researches and trades securities in an effort to generate market-beating returns, while passively managed funds seek to match the returns of a market index (like the S&P 500).

Actively managed funds usually have higher fees than passively managed funds due to the added expenses associated with active management and higher sales charges due to more active trading. Keep in mind that there’s no guarantee that actively managed funds will generate higher returns than passively managed funds.

**Selecting Plan Service Providers**

The first step in understanding and scrutinizing retirement plan fees is to create an objective process to guide your decision making.

Before selecting a service provider, think carefully about the specific services you need—whether accounting, legal, custodian, recordkeeping, or investment education. For example:

- What types of reports do you need, and how frequently do you need them?
- What kinds of participant communications and meetings are required?
- What frequency is needed for participant investment transfers?
- Also think about how much responsibility you want the service provider to assume, as well as:
  - What services must be included with the plan
  - Any extra or customized services you want to provide for participants
  - Any optional features you want to offer participants (e.g., plan loans, online trading, telephone transfers)

When interviewing prospective service providers, give the providers the same information about your plan (e.g., number of participants, amount of plan assets) and your desired features so you can make meaningful comparisons among them.

And be sure to request detailed information about their services. This will help you determine the reasonableness of their fees based on the level of services provided and gauge any potential conflicts of interest that could affect their performance.

Finally, remember that monitoring the reasonableness of plan fees is an ongoing responsibility. You should monitor plan fees and expenses on a regular basis to determine whether they remain reasonable given the level and quality of services provided and the performance of plan investments.

**Guarding Against Participant Lawsuits**

Recent years have seen a growing number of lawsuits in which plan participants are suing sponsors over the reasonableness of plan administrative and investment fees. In fact, more than half of the 401(k) plan sponsors who responded to a recent survey conducted by Cerulli Associates voiced concerns about such litigation.

An independent investment advisor or third-party administrator can analyze all of your retirement plan fees and compare them to benchmark data to gauge how reasonable they are. This can be a good way to guard against participant lawsuits and ensure that you’re fulfilling your fiduciary duty in regard to ensuring the reasonableness of plan fees.
Make Sure Your Annual Census Report Is Accurate

Each year, you are responsible for providing a comprehensive census report to your third-party administrator (TPA) and other relevant service providers. The census report is the starting point for your plan’s audit, so it’s critical to ensure that the data is accurate, timely, and complete.

Not submitting accurate employee data could lead to a host of problems—including possible failure of annual non-discrimination tests. Here are a few things to keep in mind as you prepare your annual employee census:

- Include your entire employee population. This includes employees who are eligible and ineligible to participate in your plan.
- Correctly identify employees as union or non-union because union employees are often excluded from plans and need to be segregated for testing.
- List both employee and employer contribution amounts to the plan for the year.
- Pay especially close attention to details such as employees’ birthdays and dates of hire. Errors in these seemingly simple areas can lead to big problems.
- Make sure that former employees who no longer work for your company have been deleted from the census.
- Also confirm that the total amount of annual compensation in the census meets the definition of compensation in the plan document. If total compensation in the census doesn’t match the amount reported as gross wages on payroll reports, these should be reconciled as a test to prove the accuracy and completeness of the census information.

Once your census is complete, reconcile the total annual compensation and employee contribution data with your annual payroll data. Then choose a random sample of employees and confirm that the data contained in the census matches the data contained in their personnel files.

Have more questions about your census report? Give us a call—we’d be happy to answer them for you.