Fees are Falling…Right?

Trends in Retirement Plan Expenses

Retirement plans pay a variety of fees for services rendered, which can generally be broken down into two categories: Plan Administration expenses and Investment expenses. Fees for plan administration cover the day-to-day operation of the plan including recordkeeping, accounting, legal, and trustee services, as explained by the DOL's Employee Benefits Security Administration in "Understanding Retirement Plan Fees and Expenses"[1]. In some instances, plan administration expenses will be charged similarly to an investment fee, deducted directly from returns. Alternatively, administrative expenses may be paid, in whole or in part, by the employer or passed on to the participants based on their account balance or as a flat fee. Investment related fees are charged for the management of plan investments and are generally assessed as a percentage of plan assets. Because plan expenses ultimately affect a participant's account balance at retirement, retirement plan fees have been under intense scrutiny in recent years.

Morningstar Fee Research

Continuing a trend from the previous year, investors are paying less for investment management than they have in the past. According to the latest research[2] conducted by independent investment research firm Morningstar, expense ratios are being driven down by a consumer demand for low-cost funds. The asset-weighted expense ratio across all funds in the Morningstar universe[3] was 0.61% in 2015, down from 0.64% in 2014, and an even steeper decrease from 0.73% just five years prior. The 2015 Morningstar Fee Study[4] showed that from 2009 to 2014, 63% of fund share classes and exchange-traded products reduced their expense ratio with 24% decreasing by more than 10%. However, 21% actually increased their fees during this time.

Although investment expenses are falling, the Morningstar Fee Study found that estimated industry fee revenue reached an all-time high of $88 billion in 2014, up from $50 billion in 2004. This is due to an increase in assets under management which rose 143% during the 10 year period. During the same timeframe, the asset-weighted expense ratio decreased by 27%.

A Comprehensive View of Plan Costs

Looking solely at investment expense, however, does not give an accurate depiction of total plan expenses. Annually, the 401k Averages Book is published by Pension Data Source, Inc. with updated comparative cost information for plans segmented by number of participants, average account balance, and total plan assets. The latest, 16th edition[5], contains cost information for a universe of 193 products offerings from 69 providers, updated through September 30, 2015. The book is separated into two major segments, plans with $50,000 average account balances, and those with $10,000 average account balances. Each segment has 8 scenarios with cost information based on participant counts from 10 up to 2,000. While

[1] Understanding Retirement Plan Fees and Expenses. United States Department of Labor. Employee Benefits Security Administration.
[2] Oey, P. and West, C. Average Fund Costs Continued to Decline in 2015. Morningstar. 26 April 2016.
[3] The universe considered for this study includes all U.S. mutual funds and exchange-traded products, excluding money market funds and funds of funds, except if noted. The data source is Morningstar, Inc. as of 3/12/2015.
[4] Johnson, B. and Rawson, M. 2015 Fee Study: Investors Are Driving Expense Ratios Down. Morningstar.
[5] 401k Averages Book, 16th edition. All rights reserved.

most plans will not fit perfectly into one of these specific scenarios, the information is useful for fee benchmarking and to analyze how total plan expenses have changed.

The Evolution of Expenses

In comparing the cost data from 2015 to the previous year[6], a few trends emerge. In each scenario, the net investment expense decreased, illustrated in the graphs below. As explained in the Morningstar research, this is most likely due to consumer demand for lower cost funds.

Figures 1 & 2. Average Plan Cost as a Percentage of Assets - 200 Participant Plan

Figure 1

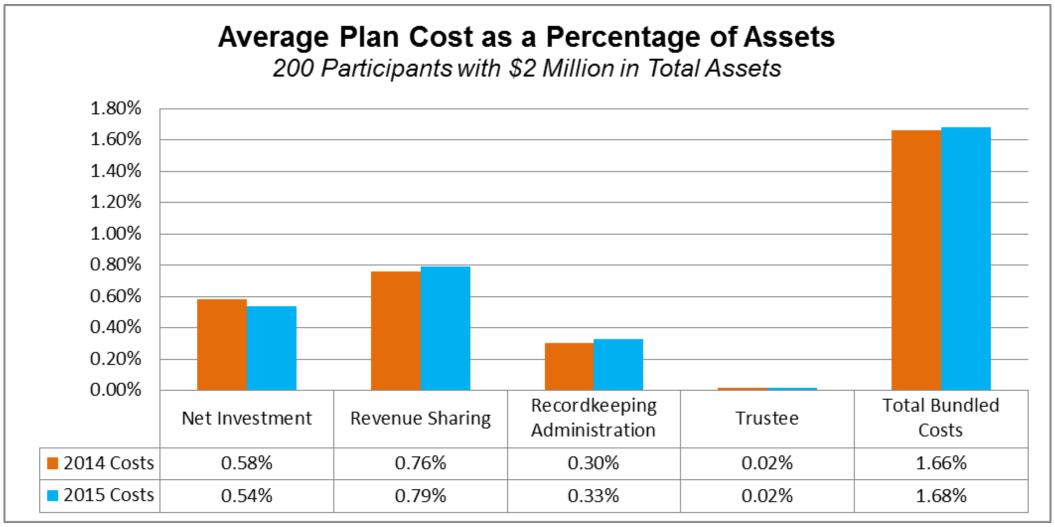
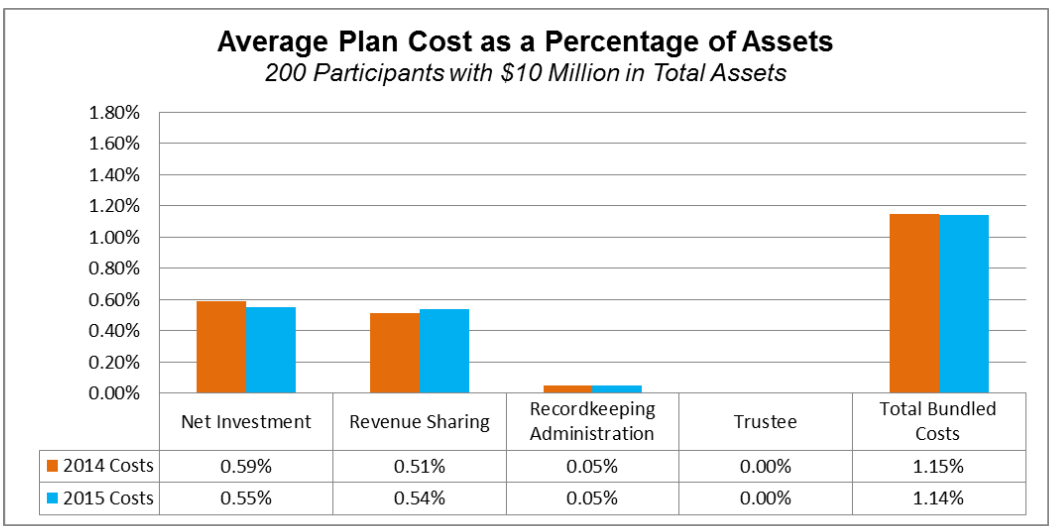


Figure 2

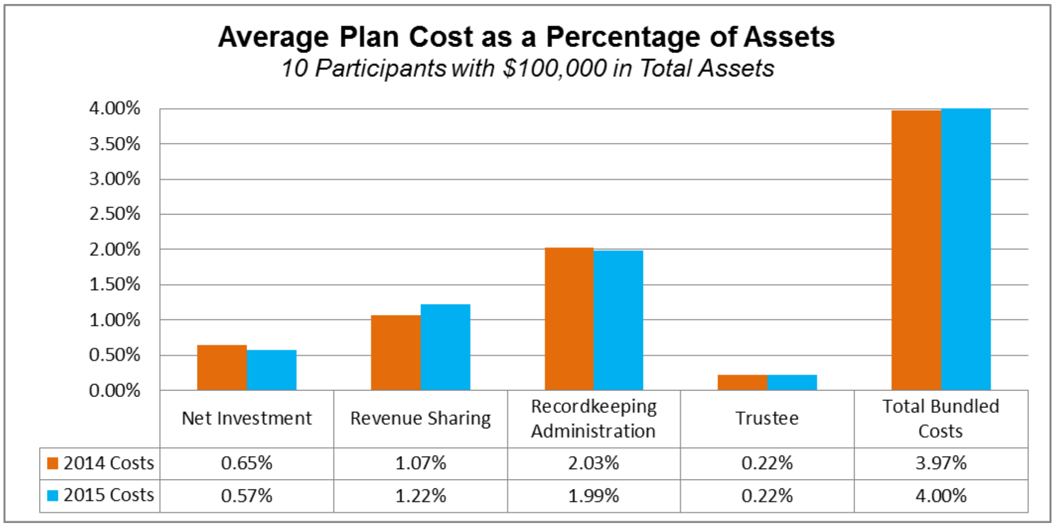


Another common trend found in these scenarios is increasing revenue sharing expenses. Except in the scenarios with more than 1,000 participants and $50,000 average account balances, revenue sharing expense increased in each case. For the small plan scenarios with fewer than 25 participants and $250,000 or less in total assets, revenue sharing expense increased more than 0.10% of plan assets, on average.

[6] The 401k Averages Book, 15th edition contains data updated through September 30, 2014. The 401k Averages Book, 16th edition contains data updated through September 30, 2015.

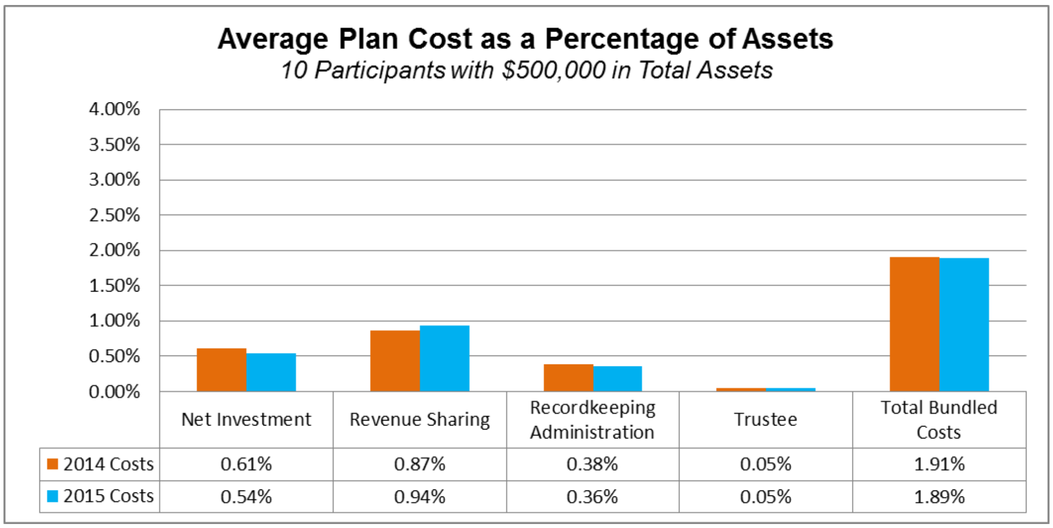
Figures 3 & 4. Average Plan Cost as a Percentage of Assets - 10 Participant Plan

Figure 3



	Net Investment	Revenue Sharing	Recordkeeping Administration	Trustee	Total Bundled Costs
2014 Costs	0.65%	1.07%	2.03%	0.22%	3.97%
2015 Costs	0.57%	1.22%	1.99%	0.22%	4.00%

Figure 4



	Net Investment	Revenue Sharing	Recordkeeping Administration	Trustee	Total Bundled Costs
2014 Costs	0.61%	0.87%	0.38%	0.05%	1.91%
2015 Costs	0.54%	0.94%	0.36%	0.05%	1.89%

Fred Reish, a partner in the Employee Benefits & Executive Compensation Practice Group at the Drinker Biddle & Reath law firm, frequently writes about the evolution of revenue sharing over time. In April 2015, he discussed an evolving trend where mutual funds pay revenue sharing, including 12 b-1 and sub-transfer agent fees, to 401(k) recordkeepers for services rendered for the funds. With the 408(b)(2) regulations, the DOL began treating these revenue sharing payments as compensation to the recordkeeper. As a result, if the plan sponsor determines the recordkeeper's total compensation is now in excess of the reasonable cost for services, the fiduciary decision would be to reallocate the excess compensation back to the participant's accounts. Since some employees may not be invested in mutual funds that pay revenue sharing, another common trend is to refund all revenue sharing and to charge evenly across participant accounts for recordkeeping expenses

Conclusion

Average investment expenses are showing a multi-year declining trend, thanks to a consumer push for lower cost alternatives. However, investment costs are not the only expenses that a plan is subject to. As displayed by the scenarios in the 401k Averages Books, revenue sharing costs have increased overall, leaving total costs relatively flat. With advances in technology increasing efficiency and productivity, administrative costs should be decreasing but this is not a trend we are seeing across the board.

As the DOL explains, "understanding and evaluating plan fees and expenses associated with plan investments, investment options, and services are an important part of a fiduciary's responsibility".[7] Fees and expenses are not avoidable, but they should be monitored to ensure they are not in excess of the reasonable cost for services.

[7] Understanding Retirement Plan Fees and Expenses. United States Department of Labor. Employee Benefits Security Administration.