

NAGDCA ANNUAL CONFERENCE 2009

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Fees – Revenue, Expenses and Disclosure

Moderator: Jayson Davidson, CFA, Hvas Group

Speakers: Andrew Ness, Mercer Investment Consulting
Edward F. Zagajeski, MTA Deferred Compensation Program
Kandi Winters, State of Florida IRC 457 Plan

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General Overview

Andrew Ness
Mercer Investment Consulting, Inc.

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Agenda

Attention to Plan Fees

Different Types of Plan Fees

Revenue Sharing

Methods for Evaluating Fees

Disclosure and Uses for Revenues



Attention to Plan Fees

Why should plans be concerned about fees?

- **Paternalistic** – every dollar paid in fees is a dollar less that a participant has in their account for retirement
- **Legal** – there have been an increasing number of lawsuits filed against plan sponsors and providers regarding excess fees in defined contribution plans



Different Types of Plan Fees

Investor A:

- Contribute \$3,00 per year beginning at age 25
- 8% annual growth
- 1.00% annual fees
- Account value at age 65: \$688,897

Investor B:

- Contribute \$3,00 per year beginning at age 25
- 8% annual growth
- 2.00% annual fees
- Account value at age 65: \$524,852

1.00% increase in fees equates to \$164,045 over 40 years



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Attention to Plan Fees

From both media and congress:

"...suing their employers over their plans' fees"

"...excessive, undisclosed and illegal"	"Congress should hold hearings to examine the fee issue."
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"...\$29 billion – cost of excess fees to 401(k) savers"

"...employers failed to properly inform employees"	"...complicated and confusing"
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"...401(k) fees can chomp a hole in your savings"

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Different Types of Plan Fees

Provider Revenue	Investment Manager Revenue
<u>Administrative Expenses:</u> <ul style="list-style-type: none"> Asset based fee Per-participant fee Transaction based (loan fee, brokerage window fee, etc.) 	<u>Investment Expenses:</u> <ul style="list-style-type: none"> Management fee 12(b)-1 fee Sub-transfer agent (Sub TA) Other

Providers typically negotiate revenue sharing arrangements with investment managers for administration and communication costs

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Revenue Sharing

Broad based term referring to agreement between the investment manager and the provider to generally compensate for recordkeeping and communication services. Sources can include:

- 12(b)-1 – disclosed in prospectus, typically asset based
- Sub T/A – not disclosed in prospectus, typically asset based or per account, amounts are negotiable
- Management Rebates – not disclosed in prospectus, typically asset based, amounts are negotiable
- Finders Fee – disclosure in prospectus varies, paid on new money to the plan, typically asset based

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Methods for Evaluating Fees

How can a plan determine the breakdown of fees?

- **Request for Proposal Process** – typically conducted every five years, the RFP process provides plans with the opportunity to require full disclosure of plan fees, and determine who the recipients are
- **Fee Reviews** – plans will sometimes conduct fee reviews mid-contract in order to benchmark fees and evaluate reasonableness
- **Ongoing Monitoring** – many providers include a description of fees in regular quarterly reporting



Disclosure and Uses for Revenues

Disclosure of fees is important. Disclosure of revenue sharing varies from plan to plan.

- **Total Fees** – fees are typically disclosed at enrollment and are available on the plan website. Investment management fees are available for mutual funds via the prospectus, and are also typically provided on the website
- **Revenue Sharing** – plans will sometimes disclose that revenue sharing generally takes place, and will sometimes disclose the actual amounts of revenue sharing by fund; other plans do not disclose revenue sharing
 - A federal district court in Missouri ruled (*Braden v. Wal-Mart Stores Inc.*) that ERISA does not require that fiduciaries tell participants about revenue sharing arrangements



Disclosure and Uses for Revenues

Revenue sharing can be used to offset plan fees, or in some cases it is returned to participants investing in the funds.

- **Offset Plan Fees** – many plans agree to allow the vendor to retain revenue sharing in order to offset administrative costs
- **Return to Participant Accounts** – some plans return revenue sharing to participants invested in the funds; Plans utilizing this approach view this as being equitable for participants



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Basic Legal Requirements

Edward F. Zagajeski
MTA Deferred Compensation Program
New York, New York

El Paso Waco
TEXAS
Austin
San Antonio
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Legal Requirements: ERISA

- ERISA imposes fiduciary duties on plan sponsors and administrators but does not explicitly include a duty to disclose plan fees or revenue sharing agreements.
- State and municipal plan sponsors are not subject to ERISA but we often look to ERISA standards for guidance.

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STATE LAW REQUIREMENTS

- State Law and/or Regulations, if any, would be applicable to 457 Plans.

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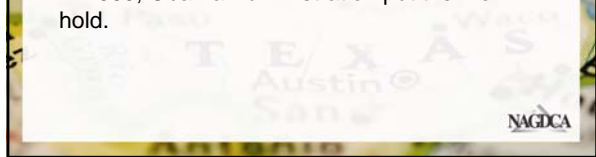
State of New York

- New York Requirements:
 - RFP proposals shall include all direct fees, indirect fees and charges.
 - Certain fees shall be negotiated so that the best competitive rate under the circumstances is obtained.
 - Fee information required in participant statements.



Proposed Federal Regulations

- In 2007 and 2008, the U.S. Department of Labor proposed regulations on fees and disclosure.
- In 2009, Obama Administration put them on hold.



Proposed Federal Legislation

Defined Contribution Fee Disclosure Act of 2009 (S. 401):

- Would amend ERISA to require plan providers to disclose fees to plan fiduciaries who could provide it to participants upon request.



401(k) Fair Disclosure for Retirement Security Act (H.R. 1984)

- Plan Sponsor:
 - Prior to entering a contract, plan provider must disclose fees and charges and be itemized.
 - Disclose potential conflicts of interest.
- Plan Participants:
 - Prior to enrollment, detail of costs of participation.
 - Quarterly statements: costs of participation, investment performance.

401(k) Fair Disclosure and Pension Security Act (H.R. 2989):

- Requires breakdown of 401(k) fees into 4 categories:
 - (1) asset-based investment charges,
 - (2) asset-based charges not specific to investments,
 - (3) administrative and transaction based charges,
 - (4) other charges.

Court Decisions in Fee Litigation

- *Hecker v. Deere*
7th Circuit Court of Appeals, February 2009.

Relevant Facts in *Hecker v. Deere*

- Bundled Plan: Employer agreed to use TPA affiliated mutual funds and a brokerage window.
- Employer in 401(k) Plan selected specific investment options available to participants.
- Investment fees disclosed.
- Employer paid administrative and trust costs for the plan.

Decision in *Hecker v. Deere*

- TPA: Not a fiduciary regarding the investment options.
- No duty to disclose revenue sharing; it is not material.
- ERISA safe harbor applied.

Other Cases:

- *District Court Missouri case*: Plan participants sued TPA of a bundled plan.
 - Decision: TPA could be a fiduciary because of its “role” in selecting investment options.
- *District Court Connecticut case*: Plan sponsor sued the TPA.
 - Decision: TPA could be an ERISA fiduciary because it had discretion over funds.
 - Revenue sharing could be “plan assets”.

2 457 Cases

- The same plan sponsor sued 2 different TPAs:
 - 1st in District Court Ohio.
 - 2nd in District Court Connecticut.

Both cases were dismissed.

NAGDCA Survey Results

Some Plans reported that they did not know what they paid TPA and/or consultants:

- 21 of 72 (29%) responding plans reported that they did not know what plan paid for TPA.
- 26 of 72 (36%) reported that they did not know what plan paid for plan consultants.

The Case for Disclosure

DISCLOSURE TO PLAN SPONSORS:

- Plan sponsors need fee information, including revenue sharing, to fulfill obligations to participants to maximize retirement income.
- Uniform disclosure will allow comparison and knowledge of fees and revenue sharing will only increase Plan sponsors bargaining power when negotiating with providers.
- "Separate disclosure" of fees for each service in bundled plan is needed so Plan Sponsor can select the best plan provider.
- TPA fees may fluctuate over time with value of assets and number of plan participants but the costs of such services do not similarly fluctuate.

Disclosure of Fees to Participants

- Participants knowledge of fees would allow them to decide acceptable risk level.
- Retirement funds at stake & fees can be hidden.
- A small increase in fees can mean a large decrease in retirement income.



Kandi Winters
State of Florida
Bureau of Deferred Compensation



Investment Providers

- Valic
- Great West Retirement Services
- ING
- Nationwide Retirement Services
- T. Rowe Price
- Charles Schwab

*The above information is based on the State of Florida's Deferred Compensation Plan and does not reflect any endorsement by NAGDCA.



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Product Offerings

- Mutual Funds
- Low Cost Index Funds
 - > Small Cap
 - > Long Term Bond
 - > Total Stock Market
 - > Institutional
- Target Date Funds
- Profile Funds
- Stable Value Funds
- FDIC Products
- Self-directed Brokerage Option

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QUESTIONS

