# DEFINED CONTRIBUTION PLAN FEES HIT A RECORD LOW: NEPC STUDY

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Summary

Fees related to retirement investment accounts hit a record low this year, according to a survey by NEPC, LLC. In particular, recordkeeping costs, the second largest component of total fees, saw the sharpest fall.

The drop comes on the back of a highly litigious landscape and new rules spurring greater transparency of fees charged by defined contribution plan recordkeepers. This move may offer a window of opportunity to employers to potentially garner savings for their employees' retirement accounts.

## Overview

NEPC's Defined Contribution Practice group conducts an annual Plan & Fee Survey ('Survey') to help plan sponsors, that is, employers, understand fees, pricing and structure of their defined contribution plans.

In its seventh year now, the 2012 Survey includes data from 99 plan sponsors ('sponsors') and potential clients, encompassing around one million participants contributing to their retirement accounts. A detailed break-out by plan assets and number of participants is available only to our clients and potential clients; basic findings are publicly released.

The NEPC Survey, unlike others that gauge sentiments, attitudes and perceptions, is based on numerical data. It is an in-depth study of plan fees. We don't simply ask sponsors to quantify fees. Instead, we calculate them based on data gathered from recordkeepers, custodians and trustees.

## Key Findings

- Total plan fees are the lowest they have been in the seven years NEPC has conducted the Survey;
- Recordkeeping fees have fallen 22% since 2006, with half of the decline in recordkeeping fees occurring in the last 15 months alone;
- Four-of-five of the most prevalent recordkeepers in the Survey have changed the way they approach fees; and
- Vendor searches in 2011 resulted in savings, on average, of 40% on recordkeeping fees.

The steep drop in recordkeeping fees, or costs related to documenting participant activity, in 2012 is likely fueled by new rules aimed at making fees more transparent and well-publicized litigation.

To this end, sponsors may potentially be in a position to take advantage of this fall in prices. Sponsors, at a minimum, should assess the contracts they have in place and check in with their vendors. If it has been a long while since a vendor search has been conducted, consistent with best practices, NEPC advises clients to bid out existing contracts.

## Key Data Points

In any study involving defined contribution plan fees, the following three key data points garner the most attention: Total plan cost, investment management fees and record keeping fees.

In our 2012 Survey:

- The annual median total plan cost for plan sponsors was 0.55%, or 55 cents for every $100 in fund assets, compared to 0.58% in 2011;
- The annual weighted average expense ratio was 0.52%, or 52 cents for every $100 in fund assets, compared to 0.53% in 2011; and

- The annual median recordkeeping fee was $92 for each plan participant, compared to $103 in 2011.

In 2006, when NEPC first conducted this Survey, recordkeeping fees totaled $118 per year for each plan participant. At the time, the median weighted average expense ratio stood at 0.57%.

### Background

The largest costs in a defined contribution plan are investment management fees followed by recordkeeping payments. Investment management fees are charged by money managers for running the funds in a plan; recordkeeping fees are costs related to documenting participant activity.

In addition to charging investment management fees, many investment companies include so-called revenue-sharing arrangements within their funds to help offset, and, in some instances, completely pay for, all plan-related expenses, including recordkeeping. Essentially, a portion of a fund's expense ratio is "shared" to pay for plan expenses.

For years plan sponsors have been concerned about the transparency of these revenue-sharing arrangements. Their main worries: the overall level and reasonableness as well as the equitability of the fees. For instance, it is common for plan sponsors to offer in their plans some funds with revenue-sharing features and others with none. Accordingly, participants may pay higher administrative expenses on certain funds over others, depending on the funds selected. In addition, the actual payments differ among participants; participants with higher balances may pay more fees and vice-versa.

To address these concerns, some sponsors have considered alternative billing methods. For instance, fees may be assessed as a dollar amount for each participant rather than following an asset based approach.  In line with the heightened scrutiny and new rules demanding greater transparency in fee reporting, recordkeepers are also taking a closer look at the level and structure of fees. Gone are the days of inflexible investment platforms and, importantly, as we look forward, the opportunities for hidden fees are diminished.

This year, as sponsors review their specific circumstances, they will see the impact of a few directionally opposed forces. On the one hand, the equity markets rose and asset based revenues should have increased accordingly. In addition, greater transparency led to the disclosure of additional line items which represented an increase in reported fees. However, with the new transparency regulations looming, several recordkeepers chose to reduce recordkeeping fees. We observed that, in the majority of cases, the reduction in recordkeeping fees overwhelmed other factors.

Interestingly, recordkeeping fees saw a sharper fall (11%) than the overall expense ratio (2%) of which they are often a component. This may be explained, in part, by recordkeepers shifting fees to one part of the business from another; for instance, accepting lower administrative revenues on one side but seeking higher investment management revenues on the other. To this end, plan sponsors should press recordkeepers for a reduction in total fees and not settle for a mere rebalancing of the different fee categories. At the end of the day, sponsors shouldn't feel like they are merely squeezing a balloon (shifting fees from one side of the house to the other).

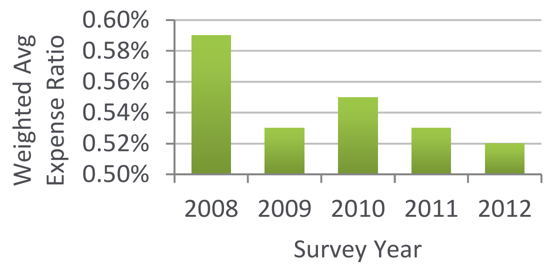
As a practical consideration,  with record keepers looking to increase investment revenues to offset lower record keeping margins, getting proprietary assets under management has re-emerged as a key focus. Recordkeepers really want to manage the target date funds, for example. When considering changes to capture fee savings, Plan sponsors must make prudent decisions incorporating all factors and they shouldn't operate in a vacuum. Changing investments to capture lower fees does not make sense in all cases.

### Glossary of Terms

**The Weighted Average Expense Ratio:** an asset-weighted average expense ratio of all funds offered in a plan. This ratio's calculation is influenced heavily by participant allocations. Large plans tend to have lower expense ratios than smaller plans because they enjoy economies of scale stemming from their more substantial asset bases. Large plans also tend to have lower record keeping and/or revenue-sharing requirements per participant.

Traditionally, weighted average expense ratios have been in the 0.55%-0.60% range. NEPC's 2012 Survey findings indicate a plan median of 0.52% compared to 0.53% in 2011. Overall, we expect the trend towards lower expense ratios to continue in the near-term.

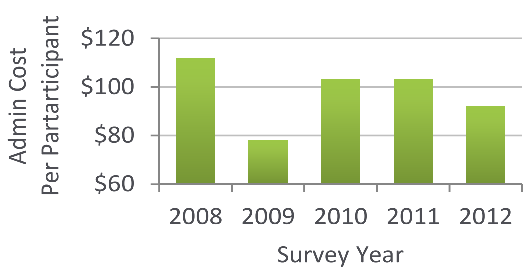
Weighted Average Expense Ratio




**Recordkeeping Fees:** the plan median recordkeeping fee. Recordkeeping fees can be explicit (per plan participant) or implicit (based on asset based fees). While we reference "recordkeeping" fees, our definition of recordkeeping fees encompasses administrative costs, such as, trust/custody services and communications, in addition to recordkeeping. The general rule is that the more participants in a plan, the lower the recordkeeping fees per head.

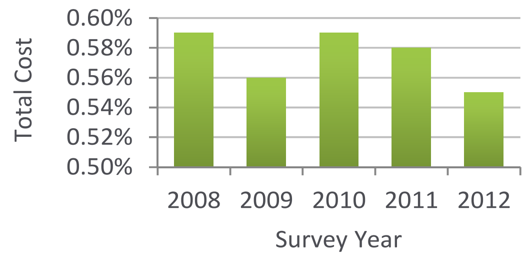
The 2012 survey results show a median recordkeeping fee of $92 per year for each participant, compared to $103 in 2011. During the same period, the Standard & Poor's 500 Index gained 15%. Thus, despite the increase in revenue from assets, fees have fallen on the heels of legislative changes and fear of potential litigation. The trend of declining fees reflects the attention paid to these costs and the diligent efforts of plan sponsors and their advisors to better understand and monitor these payments.

Recordkeeping Fees



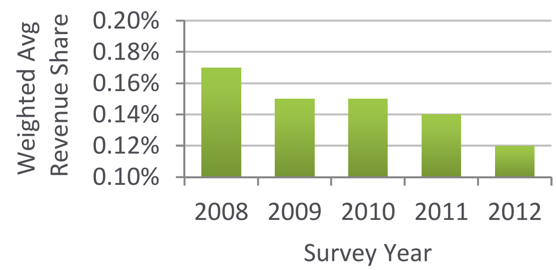

**Total Plan Cost:** is a plan's all-in cost, including fees related to investment management, recordkeeping and all other administrative services. This is the total fee paid by plan participants and the plan sponsor.

Total Plan Cost




**Weighted Average Revenue Sharing:** is an average of the different levels of revenue-sharing among options offered in a plan. Typically, sponsors focus on the fee per participant, but this number comes in handy when sponsors wish to estimate a reasonable level of imbedded fees for a plan of a particular size. It is also helpful for those plan sponsors who are evaluating whether other plan sponsors are moving away from asset based fee models. Consistent with other 2012 Survey findings, revenue-sharing arrangements have declined year over year.

Weighted Average Revenue Share




## Conclusion

The 2012 Survey findings point to an evolving marketplace in which recordkeepers and plan sponsors adjust to new regulations and pertinent questions posed by litigation.

The results show a sizable change in recordkeeping fees for each plan participant. The lower fees are in line in with the trend of declining costs. Administrative fees have steadily declined since we conducted our first survey in 2006.

This study is intended as a tool to help plan sponsors understand their plan fees. If you have questions about the survey, or would like to be included in the results, contact your NEPC consultant at 617-374-1300.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