NEPC 2014 DEFINED CONTRIBUTION PLAN & FEE SURVEY: WHAT PLAN SPONSORS ARE DOING NOW

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Overview

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

In its ninth year now, the 2014 Survey includes data from 113 plans, encompassing over 1.4 million plan participants. A detailed break-out by plan assets and number of participants is available to our clients, prospects and Survey participants; a summary of findings is publicly released.

In any study involving defined contribution plan fees, the following three key data points garner the most attention: total plan fees, investment management fees and recordkeeping fees. 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.

This year, in addition to these data, we also focused on the way in which plan sponsors contracted with their record keepers.

Summary

The recordkeeping fees for the majority of retirement investment accounts are still calculated using pricing models based on assets within the plan, according to NEPC's 2014 Defined Contribution Plan & Fee Survey. For most plans, recordkeeping fees include some element of revenue sharing. A recordkeeping fee structure based on a fixed-dollar amount per participant in the plan—widely regarded in the investment industry as the most transparent and fair approach—appears to be gaining traction and is especially popular among the larger plans, that is, those with $1 billion or more in assets, according to the Survey.

The Survey underscores the challenge facing plan sponsors: they have to balance the quality of services provided with their efforts to cut costs and improve transparency. To this end, plan sponsors may be better served if they examine their recordkeeping fee structures, exploring the potential to migrate to a more explicit fee model, for instance, one that charges a fixed-dollar amount per plan participant.

Recordkeeping Contracts

In order to compile these results, we categorized how plans were contracted for recordkeeping services. Each plan was placed in one of the following four groups:

· Bundled – All recordkeeping fees are covered by some portion of the funds' expense ratios. A specific fee level is not contracted.

· Fixed-Dollar Per Head – The recordkeeping fees are calculated as an explicit fixed-dollar fee per participant in the plan. The fees can be charged to plan participants directly or covered by a portion of the funds' expense ratios.

· Fixed-Basis Point – The recordkeeping fees are

Exhibit 1: Contracting Data

Contract Type	# of Plans	Median # of Participant	Median Assets	# Of Plans Without Rev	Median Record Keeping, Trust & Custody Fees	Median Weighted Ave Exp Ratio
Bundled	52	4,835	$361	0	$86	0.52%
Fixed $ Per Head	33	13,244	$1,476	10	$50	0.33%
Fixed Basis Point	20	4,450	$347	3	$94	0.56%
Other	8	7,246	$567	3	$44	0.48%

Source: Fee Survey

calculated as an explicit fixed-basis point of the volume of assets in the plan. The fees can be charged via a fee accrual or a portion of the funds' expense ratios.

· Other – The recordkeeping fees are covered through some combination of dollar per head and basis point approaches.

Key Findings in 2014 Survey

- 64% of plans have contracted recordkeeping fees in a bundled or fixed-basis point structure
- 85% of plans have some level of revenue sharing
- 29% of plans have fixed-dollar per head recordkeeping arrangements. Of these, 61% have $1 billion or more in plan assets. Of the 29%, only 30% have no revenue sharing.

The breakdown of our observations can be found in Exhibit 1. Our results suggest that smaller plans are more likely to pursue a bundled approach, while larger plans typically opt for a fixed-dollar per head approach. This is because larger plans, by virtue of their size, tend to have greater resources at their disposal. As a result, they are usually ahead of the curve in adopting a new trend and set the tone for the rest of the industry. They also enjoy the benefits stemming from economies of scale. It is not surprising, then, that plans with a fixed-dollar per head fee model have lower reported recordkeeping, and trust and custody fees than the bundled plans. The data summarized later in this paper support the general premise that larger plans have lower fee structures.

Our findings also show that 40% of plans in this Survey now have plan expense reimbursement accounts (PERA). These accounts allow plan sponsors to capture dollars in excess of predetermined recordkeeping fees and use them for other plan expenses. For instance, under the fixed-dollar per head fee structure, money left over from revenue sharing agreements after paying recordkeeping fees may be used by the employer to pay for other plan services such as communication. In a fixed-dollar per head fee structure, recordkeeping fees are usually capped and do not rise as assets increase; this allows PERA balances to grow. This does not hold for bundled fee arrangements, whose fees typically rise in line with assets in the plan. In a sign of the times, recordkeeping companies with traditional fee structures are now offering low-per head fees and plan reimbursement accounts to keep up with changing demand and remain competitive.

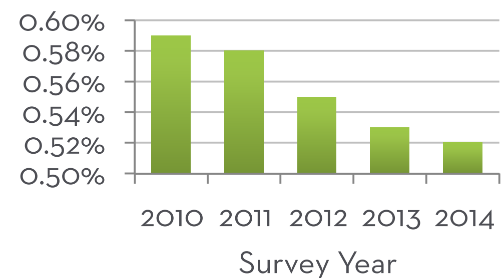
The data also show that retirement investment accounts with fixed-dollar per head fee models have the most plans with no revenue sharing; this enhances their transparency. This finding is consistent with the result that larger plans are more likely than smaller plans to have no revenue sharing.

General Findings in 2014 Survey

- **Estimated Plan Fees:** In 2014, the median estimated plan fees for employers stood at 0.52%, or 52 cents for every $100 in fund assets, compared to 0.53% in 2013 (see Exhibit 2).

Estimated plan fees are a plan's all-in costs, in-

Exhibit 2: Estimated Plan Fees



Source: Fee Survey

cluding fees related to investment management, recordkeeping, and trust and custody services. These fees have declined steadily in recent years amid regulatory changes and increased litigation.

- **Weighted Average Expense Ratio:** Plan expense ratios have also declined in recent years. The weighted average expense ratio totaled 0.49%, or 49 cents for every $100 in fund assets, compared to 0.52% in 2013. In 2006, when NEPC first conducted this Survey, the median weighted average expense ratio stood at 0.57%.

Operating expenses are paid out of a fund's assets and lower the return to a fund's investors. An expense ratio measures the costs to operate funds within a plan. It is calculated annually by dividing the funds' operating expenses by the average dollar value of assets under management. The weighted average expense ratio is a plan's expense ratio weighted by assets in the plan. This ratio's calculation is heavily influenced 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 recordkeeping and/or revenue-sharing requirements per participant.

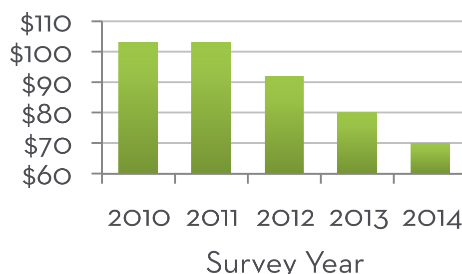
- **Recordkeeping, Trust and Custody Fees:** The median recordkeeping fee was $70 for each plan participant in 2014 compared to $80 a year earlier. Fees have fallen despite the fact that the majority are asset based and during the same period, the Standard & Poor's 500 Index gained 32%. 2006, the first year of the NEPC Survey, annual recordkeeping fees totaled $118 for each plan participant. The last five years are detailed in Exhibit 3.

These falling costs are in line with the trend of lower fees even as assets grow, underscoring the impact of increased legislation and fear of potential litigation. This trend downward has been also fueled by the heightened scrutiny around these fees by plan sponsors, their advisors and recordkeepers themselves. Recordkeeping fees can be explicit (per plan participant) or implicit (based on the level of assets within a plan). The general rule is that the more participants in a plan, the lower the recordkeeping fees per head.

Note: Our focus this year was on the level of contracted fees as opposed to actual fees paid out since the latter may be offset by PERA balances. PERA balances, while generated by plan participants, were not counted toward contracted fee levels. The prevalence of these offsets and PERA balances—now comprising 40% of plans—has helped to reduce the cost per participant (compared to prior years) despite plan assets being at their highest level. As a result, this year's recordkeeping fee per participant cannot be compared to previous years.

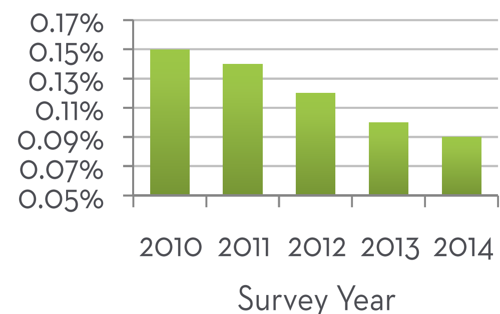
- **Weighted Average Revenue Sharing:** The Survey findings point to declining revenue sharing arrangements year-over-year (see Exhibit 4). For instance, this year weighted average revenue sharing arrangements stood at nine basis points compared to 10 basis points in 2013. This is an average of the different 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 fees for a plan of a particular size. It is also helpful for plan sponsors who are evaluating whether other plan sponsors are moving away from fee models that are

Exhibit 3: Record Keeping, Trust and Custody Fees



Source: Fee Survey

Exhibit 4: Weighted Average Revenue Share



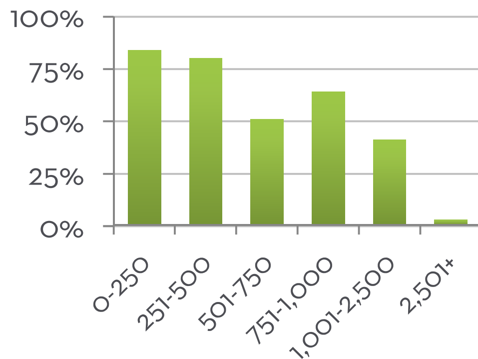
Source: Fee Survey

based on the assets within a plan.

While there has been much discussion in the industry about the appropriateness of revenue sharing arrangements, regulators have been generally supportive of the practice of revenue sharing to help pay a plan's administrative expenses.

- **Plan Options with Revenue Sharing:** On average, 50% of plan options have some form of revenue sharing, according to the Survey, down from 61% in 2013 (see exhibit 5). Exhibit 5 illustrates the percentage of fund options that provide revenue sharing. It shows the prevalence of revenue producing funds, particularly in the smaller plan sizes. The plans are divided into six categories based on asset size.

Exhibit 5: Median Percentage of Plan Options With Revenue Sharing



Source: Fee Survey

We also measured the number of plans where there is no form of revenue sharing for any of the fund options. This year, 14% of plans fell into that category compared to 13% in 2013. Not surprisingly, it was the larger plans which had no form of revenue sharing; most plans in the Survey with over $2.5 billion in assets had zero plan funds with revenue sharing.

Other Findings

In addition to fees, the Survey explores other data related to investments and plan design. From an investment perspective, the number of investment options has not changed and target date funds continue to be the turnkey solution for most plans.

Recent guidance from the Department of Labor suggests that sponsors should consider whether "custom" target date funds make sense for their population. Plan sponsors continue to assess custom approaches and our data finds that about 14% of respondents offer custom target date funds. This figure is consistent with last year's finding.

While managed accounts have received a great deal of attention in the press, they are offered by only one quarter of the plans. Several of the data points from the Survey include but are not limited to the following observations in Exhibit 6:

Exhibit 6: 2014 Survey Results vs. 2013 Survey Results

	Survey Results 2013	Survey Results 2014
Average participation rate:	78%	77%
Cost		
Average weighted-average expense ratio:	0.52%	0.49%
Estimated annual cost of administration (per participant):	$80	$70
Have Plan Expense Reimbursement Accounts (PERA):	37%	40%
Investment Structure		
Median number of investment options:	22	22
Offer Target date/lifestyle funds:	100%	100%
- Offer lifestyle	4%	4%
- Offer Target date	95%	96%
Offer company stock:	20%	24%
Offer non-mutual fund vehicles:	74%	75%
Use diversified investment option as default:	96%	96%
- Target date	92%	91%
- Other	4%	5%
Plan Features		
Offer brokerage window:	42%	45%
Offer managed accounts:	16%	24%
Use automatic enrollment:	51%	53%
- Use diversified default	100%	100%
- Average deferral rate with automatic enrollment:	3.7%	3.5%

Source: Fee Survey

Conclusion

Recordkeeping fees for many plans employ a bundled fee structure and/ or are still calculated using pricing models based on assets within a plan. In addition, a majority of the plans continue to employ revenue sharing practices. The Survey also points to declining costs.

Plans that are contracted on a fixed-dollar per head basis show a lower cost than the ones whose fees are based on assets under management. Although the analyses doesn't take into account the quality of service—a critical consideration—opportunities may exist for sponsors to reduce fees through fixed-dollar models. Opportunities may also exist to cap recordkeeping fees via plan reimbursement accounts. Such accounts are an increasingly available tool.

This study is intended to help plan sponsors benchmark 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.

Disclaimers and Disclosures

- The information in this report has been obtained from sources NEPC believes to be reliable. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.
- The opinions presented herein represent the good faith views of NEPC as of the date of this report and are subject to change at any time.
- All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.
- This report contains summary information regarding the approaches described herein but is not a complete description of the research that supports these approaches. This analysis does not constitute a recommendation to implement any of the aforementioned approaches.

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