NEPC 2015 DEFINED CONTRIBUTION PLAN & FEE SURVEY: WHAT A DIFFERENCE A DECADE MAKES

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A Decade of Change

NEPC's Defined Contribution practice group conducts its 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 tenth year now, the 2015 Survey includes data from 113 plans, encompassing over 1.4 million plan participants.

When NEPC first conducted the Survey a decade ago, the defined contribution landscape was very different (Exhibit 1). Our Survey began at a watershed moment for defined contribution programs amid intensifying efforts to increase transparency in fees and automation in plan design. The Pension Protection Act would subsequently be passed and major lawsuits aimed at fees would follow soon after. Now, the steep decline in plan fees has left us wondering whether fees can possibly fall any further. Ten years ago, only one in four plans automatically enrolled participants and, while target date funds were growing in popularity, less than 40% of plans used a diversified default vehicle of any kind. Currently, almost all plans offer a diversified default.

During this time, we have also witnessed numerous changes to rules, including the issuance of the QDIA regulations, an update to the safest available annuity directive, advice regulations, 408b2, and 404a-5. In addition, we have seen a Supreme Court ruling on company stock and a request from the Department of Labor for information on brokerage windows. Currently, the DOL is determining a new standard for what constitutes a fiduciary.

Given the volume of regulatory changes and lawsuits, it is more important than ever for defined

Exhibit 1: 2015 Survey Results vs. 2006 Survey Results

	Survey Results 2015	Survey Results 2006
Cost		
Average weighted-average expense ratio	0.46%	0.57%
Estimated annual cost of administration (per participant)	$64**	$118**
Have Plan Expense Reimbursement Accounts (PERA)	58%	20%*
Investment Structure		
Median number of investment options	22	14
Offer Target date/lifestyle funds	96%	74%
Offer company stock	24%	24%
Use diversified investment option as default	95%	38%
Plan Features		
Offer brokerage window	46%	19%
Offer managed accounts	23%	13%
Offer Roth 401(k)	39%	18%*
Use automatic enrollment	54.0%	26.0%

Source: NEPC Survey

**2007 Survey Data*

***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. As a result, this year's recordkeeping fee per participant cannot be directly compared to all previous years. That said, figures listed in the table for 2006 will not be dramatically different if we used actual fees paid out.*

Exhibit 2: DC Plans Contracting Arrangements

Contract Type	# of Plans	Median # of Participants	Median Assets (Million)	# Of Plans Without Rev Share	Median Record Keeping, Trust & Custody Fees	Median Weighted Avg Exp Ratio
Bundled	37	5,014	$405	0	$72	0.50%
Fixed $ Per Head	54	8,740	$1,002	13	$60	0.36%
Fixed Basis Point	20	4,680	$365	3	$84	0.53%
Other	5	3,003	$99	0	$94	0.64%

Source: NEPC 2015 Defined Contribution Plan & Fee Survey

contribution plan sponsors and their investment committees to employ a prudent, transparent and effective decision-making process.

Summary

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. This year, in addition to these data, we once again focused on the way in which plan sponsors contracted with their record keepers. Please refer to Exhibit 2 for a detailed breakdown of our observations.

Perhaps the most notable observation is the growing appeal of recordkeeping fee structures based on a fixed-dollar amount per plan participant—widely regarded in the investment industry as the most transparent and fair approach. Fixed-dollar arrangements now account for 47% of plans in our Survey. While previously popular among larger plans, that is, those with $1 billion or more in assets, fixed-dollar arrangements are now increasingly prevalent among mid-size plans with $100 million to $500 million in assets, according to the Survey. That said, the recordkeeping fees for half of all retirement investment accounts are still calculated using pricing models based on assets within the plan. In addition, recordkeeping fees include some element of revenue sharing for most plans.

We also continue to observe a steady decline in plan fees, including investment management fees and recordkeeping fees. For instance, the median recordkeeping fee was $64 for each plan participant in 2015 compared to $70 a year earlier. This erosion in fees leaves little wriggle room for more cost savings; plan record keepers cannot continue to provide the highest levels of service if profit margins are non-existent.

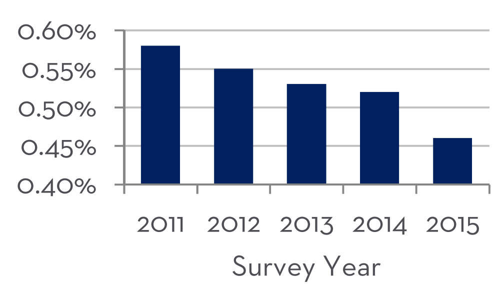
The Survey results also underscore the challenge facing plan sponsors: they have to balance the quality of services provided with their efforts to cut costs and improve transparency. To this end, plan sponsors may be better served if they examine their recordkeeping fee structures, exploring the potential 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 plans according to the structure of their 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 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.

Exhibit 3: Estimated Plan Fees



Source: NEPC 2015 DC Survey

2015 Survey: General Findings

- Our findings show that 50% of defined contribution plans have contracted recordkeeping fees in a bundled or fixed-basis point structure.

- Results indicate 87% of plans have some level of revenue sharing.

- Of the plans surveyed, 47% have fixed-dollar per head recordkeeping arrangements. Of these, 52% have $1 billion or more in plan assets; of the 47%, only 24% have no revenue sharing.

- This year, an increasing number of mid-sized plans indicated their use of a fixed-dollar per head arrangement for recordkeeping fees; 43% of these fixed-dollar per head arrangements were contracted in the last three years. (This differs from a year earlier, when Survey results indicated that mid-sized plans were more likely to pursue a bundled approach, while larger plans typically opted for a fixed-dollar-per head approach.)

- NEPC's findings also show that 58% of plans in the Survey have plan expense reimbursement accounts (PERA). These accounts allow plan sponsors to capture dollars in excess of pre-determined 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 materials for plan participants. 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 to remain competitive.

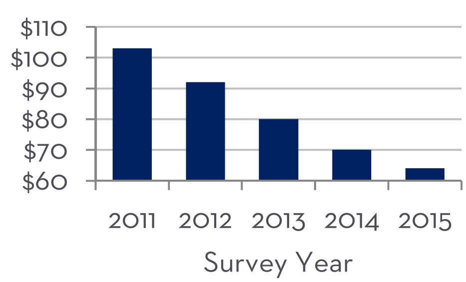
- The data also show that retirement investment accounts with fixed-dollar per head fee models have the most plans with no revenue sharing; this enhances their transparency. This finding is consistent with the finding that larger plans are more likely than smaller plans to have no revenue sharing.

- In 2015, the median estimated plan fees for employers stood at 0.46%, or 46 cents for every $100 in fund assets, compared to 0.52% in 2014 (Exhibit 3). Estimated plan fees are a plan's all-in costs, including fees related to investment management, recordkeeping, and trust and custodial services. These fees have declined steadily in recent years amid regulatory changes and increased litigation.

- Average expense ratios (the expenses charged by a mutual fund, for example) have also declined in recent years. The weighted average expense ratio totaled 0.46%, or 46 cents for every $100 in fund assets in 2015, compared to 0.49% a year earlier. In 2006, when NEPC first conducted the Survey, the weighted average expense ratio stood at 0.57%.

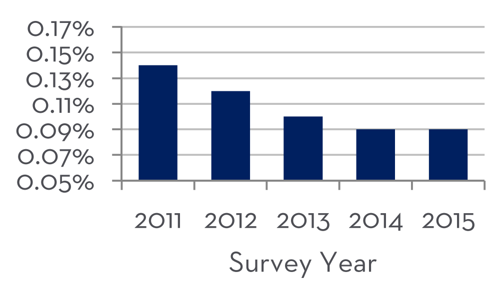
  Operating expenses are paid out of a fund's assets and lower the return to a fund's investors. An expense ratio measures the costs to operate funds within a plan. It is calculated

Exhibit 4: Record Keeping, Trust and Custody Fees



Source: NEPC 2015 DC Survey

Exhibit 5: Weighted Average Revenue Sharing



Source: NEPC 2015 DC Survey

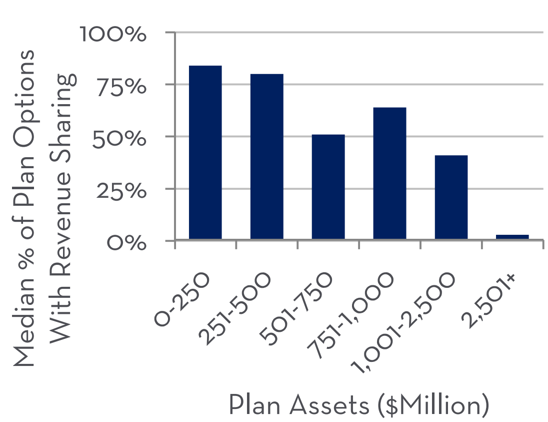
annually by dividing the funds' operating expenses by the average dollar value of assets under management. The weighted average expense ratio is a plan's expense ratio weighted by assets in the plan. This ratio's calculation is heavily influenced by participant allocations. Large plans tend to have lower 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.

- The median recordkeeping fee was $64 for each plan participant in 2015 compared to $70 a year earlier. Fees have fallen despite the fact that half the fee structures are asset based and, during this period, the Standard & Poor's 500 Index gained 13.7%. In 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 4.

  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 lawsuits. This trend downward also has been fueled by the heightened scrutiny around these fees by plan sponsors, their advisors and record keepers 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.

Exhibit 6: Median Percentage of Plan Options With Revenue Sharing



Source: NEPC 2015 DC Survey

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

Exhibit 7: 2015 Survey Results vs. 2014 Survey Results

	Survey Results 2015	Survey Results 2014
Average participation rate	83%	77%
Cost		
Average weighted-average expense ratio	0.46%	0.49%
Estimated annual cost of administration (per participant)	$64	$70
Have Plan Expense Reimbursement Accounts (PERA)	58%	40%
Investment Structure		
Median number of investment options	22	22
Offer Target date/lifestyle funds	96%	100%
- Offer lifestyle	8%	4%
- Offer Target date	94%	96%
Offer company stock	24%	24%
Offer non-mutual fund vehicles	84%	75%
Use diversified investment option as default	95%	96%
- Target date	90%	91%
- Other	5%	5%
Plan Features		
Offer brokerage window	46%	45%
Offer managed accounts	23%	24%
Offer Roth 401(k)	39%	33%
Use automatic enrollment	54%	53%
- Use diversified default	100%	100%
- Average deferral rate with automatic enrollment	3.5%	3.5%

Source: NEPC 2015 DC Survey

balances—now comprising 58% 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 directly be compared to all previous years. That said, figures listed in the table for 2006 will not be dramatically different if we used actual fees paid out.

- The Survey findings point to similar revenue-sharing arrangements year-over-year (Exhibit 5). For instance, this year, weighted average revenue-sharing arrangements stood at nine basis points, in line with 2014. 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 based on the assets within a plan.

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

- On average, 50% of plan options have some form of revenue sharing, according to the Survey, in line with the 2014 result (Exhibit 6). This shows the prevalence of revenue-producing funds, particularly in the smaller plan sizes. The plans are divided into six categories based on asset size.

- 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, in line with 2014. 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.

While managed accounts have received a great deal of attention in the press, they are offered by only one-fourth of the plans. Several of the data points from the Survey include, but are not limited to, the observations in Exhibit 7.

Conclusion

The defined contribution environment has changed materially over the last decade, heavily influenced by lawsuits centered on fees and regulation aimed at greater transparency. While most plans continue to employ revenue-sharing practices of some kind, we continue to see an increase in fixed-dollar per head arrangements.

The Survey also points to declining costs. Recordkeeping fees have fallen 46% since we first conducted our survey and 9% year-over-year. Importantly, this observation doesn't take into account the quality of service—a critical consideration. Fees cannot be assessed in a vacuum; low fees for the sake of low fees can do a disservice to plan participants if quality suffers. The marketplace has already witnessed consolidation of record keepers, a sign that fees cannot decline indefinitely.

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, please 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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