

BREAKING DOWN FEES ON A 408(b)(2)

BY SARAH PARKER, AIF®, SENIOR MANAGING DIRECTOR

Fee disclosures and fee reasonableness have been common discussion items for fiduciary reviews in the retirement plan marketplace for many years. Lawsuits continue today around excessive and hidden fees. As investment consultants, Clearstead reviews fee disclosures and investment management fees frequently; however, uncovering the actual fees paid by a plan and participants may still be still an overwhelming task for plan sponsors due to confusing formats, footnotes, and font sizes.



THE ANNUAL FEE DISCLOSURES

Annually, a defined contribution participant receives a fee disclosure called a 404(a). The Department of Labor (DOL) requires plan sponsors distribute these notices to all eligible employees and beneficiaries with an account balance. The goal of the participant fee disclosure is to illustrate plan and participant level fees but must also contain comparative performance information on the investments. Plan sponsors receive a separate fee disclosure called a 408(b)(2). The DOL requires these notices to be sent to plan sponsors by covered service providers (e.g., recordkeepers, providers of fiduciary services, accountants, auditors). The goal of this document is to disclose services provided, acknowledge fiduciary services, specify direct and indirect compensation, and the structure of compensation. What we have learned is that each service provider displays and labels information in a different format on a 408(b)(2), making interpretation somewhat difficult.

HOW TO DETERMINE FEES FROM THE 408(B)(2)

408(b)(2) fee disclosures issued by a plan's recordkeeper typically include the majority of plan service provider fees. These documents are usually 8-10 pages and include investment management, recordkeeping, and administrative fees.

The easiest place to begin is with the investment management fees, as they are typically summarized as a weighted average in a final total line. The investment management fees are the same as the weighted average sum of the net expense ratios. Many times, these are displayed as proprietary and non-proprietary fees (proprietary means the recordkeeper's investment options). Both fees are important and should be added together to determine the total investment management fees. Investment management fees also include 12-b1 fees, which may be broken out to illustrate additional fee buffers. **As an example, let's assume investment management fees total 1.00% (or 100 basis points).**

Next, finding the recordkeeping and administrative fees on a 408(b)(2) may be a bit difficult depending on how fees are paid. For plans that pay fees via revenue sharing, typically a "weighted average revenue sharing" column or "fees attributable to recordkeeping" total is provided. Revenue sharing, which is a form of compensation provided by the investment manager to the recordkeeper for allowing the offering on their platform, is included in the investment management fee and works as follows:

INVESTMENT OPTION	ASSETS	INVESTMENT MANAGEMENT FEE	REVENUE SHARING	NET FEE
ABC Fund	\$100,000	1.00%	0.25%	0.75%

Some plans pay fees via a "wrapper," which is a fee that is added to each investment option to cover recordkeeping fees and may be displayed as a "daily asset charge" column.

INVESTMENT OPTION	INVESTMENT MANAGEMENT FEE	DAILY ASSET CHARGE	NET FEE
XYZ Fund	1.00%	0.25%	1.25%

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A per-participant or base fee may also be quoted on a per-participant basis. Many times, this number is included in a paragraph or chart explaining fees. **As an example, assume recordkeeping and administrative fees total 0.25% (or 25 basis points) in addition to investment option fees.**

Lastly, transactional fees should also be included and summarized as a percentage of assets. Transactional fees would include in-service withdrawals, loan maintenance/set-up, required distributions, etc. These would be items that are outside of the typical administrative scope.

The total fees in the above examples are as follows:

- **Investment Management Fee = 1.00%**
- **Recordkeeping and Administrative Fees = 0.25%**
- **Transactional Fees = 0.03%**

Whether the recordkeeping and administrative fees are in addition to or included in the investment management fees is dependent on the fee structure. In a revenue sharing fee structure, the recordkeeping and administrative fees are inclusive (**total fees in the above example are 0.78%**). In a fixed fee, wrapper, or even per-participant fee structure, the recordkeeping and administrative fees are exclusive of the investment management fees (**total fees in the above example would be 1.28%**).

Of course other plan service provider fees may also result in receiving additional 408(b)(2) disclosures that should be reviewed and included when determined total fees. These may include investment consultants, third-party administrators, auditors, and ERISA attorneys. In addition, recordkeeper 408(b)(2) disclosures may include other fees, such as managed accounts and self-directed brokerage fees that should be taken into consideration and reviewed.

SUMMARY

Understanding all service provider fees is the first step in reviewing fees. Next, benchmarking and determining the reasonableness of the total fees and components should be accomplished. Clearstead completes annual fee benchmarking and collects all 408(b)(2) forms on behalf of our clients to help in fulfilling fiduciary duties. We utilize our client base, publicly available surveys, and third-party benchmarking services to help our clients determine reasonableness of fees.