

Full Disclosure 401(k) Pricing Models: Putting The Plan Sponsor In the Driver's Seat

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As recently as a few years ago, the high costs of retirement plan design and management were overshadowed by the fact that most plan participants were enjoying 20 to 30 percent return on investment (ROI). The market was so strong that few considered how much they were paying for their 401(k) plans. Instead, plan participants were focused on double-digit growth and their anticipated retirement.

Times have changed. A flat or declining market, coupled with industry developments, is raising red flags with investors. People now understand that things can and do go wrong. Today, more than ever before, plan sponsors need to be certain that they are making the best decisions about their 401(k) plan offerings in order to help support their employees who wish to contribute to their retirement savings.

EMPLOYER ACCOUNTABILITY AND INVESTMENT POLICY DECISIONS

Forward-thinking employers know that the reality of accountability is challenging. If, as a plan sponsor of a retirement plan, an employer does not use sound judgment and prudent fiscal planning when choosing a plan record keeper—and subsequently the funds in the portfolio—it can impact the ROI for the employee and potentially place the organization itself at risk for litigation.

For this reason, plan sponsors should consider communicating decisions via a written investment policy statement. Essential to a sound retirement plan, this document

- Is a source for employees, investment advisors, and the plan record keeper on how choices are made and expectations set. While not a legal requirement, the document should include all 401(k) related processes and policies in the event there are any future questions.
- Can be developed with the assistance of a good investment advisor or your plan record keeper.

SELECTING A PLAN DRIVEN BY PERFORMANCE, NOT COMPENSATION

Plan sponsors must be prepared to ask their 401(k) plan record keeper the right questions to ensure that the plan offered to participants is not only flexible, but also driven by performance rather than compensation. The ideal plan record keeper will create a portfolio, based on a sound investment policy statement, with appropriate fee structures.

Two of the most important issues currently raised by proponents of full-disclosure 401(k) pricing models are sub transfer agency fees and “bundling.” While the two issues are distinct, unless the plan sponsor fully understands the plan record keeper’s reasons for recommending certain funds over others, the plan may suffer financially.

SUB TRANSFER AGENCY FEES

Most individual mutual funds pay a fee to the plan record keeper for its participant “record keeping” services. This is called the sub transfer fee. Likewise, the plan sponsor pays the plan record keeper an administrative fee, usually per employee, to manage the 401(k) plan.

This sub transfer fee should ideally then be credited toward the administrative fees charged to the plan sponsor by the plan record keeper. A record keeper that abides by full disclosure pricing will make sure that the sub transfer fees are correctly transferred to the plan sponsor to help offset the administrative fees.

Bottom line: It is important to fully understand the plan record keeper’s gross recordkeeping fee policy and insist on full disclosure pricing.

BUNDLING

When a plan record keeper offers access to a limited array of funds, the practice is referred to as “bundling.” There are at least two possible reasons that a plan record keeper might limit access to fund choices: (1) the plan record keeper manages its own mutual fund

portfolio; or (2) there is an arrangement with the fund manager that is not being disclosed. This arrangement might enable the plan record keeper to actually make money on sub transfer fees, which could be an incentive to select certain funds over others that may cost less but perform better.

Regardless of the reason, it is far more advantageous for the plan sponsor to choose a plan record keeper that offers no fund choice restrictions. This is known as an “open architecture” plan. There are over 10,000 funds on the market, and plan sponsors should have access to each one of them. Funds should be chosen by performance, not because a plan record keeper has been offered a financial incentive to sell one over the other.

Another important reason to choose an open architecture plan is because it is preferable to have a 401(k) record keeping system that is not tied to a particular fund family. For example, it would be extremely difficult to replace an entire fund family whose owner also provides the record keeping. Keeping the two separate and hiring a good plan record keeper to manage the records is recommended.

ONE-STOP SHOPPING: SEIZING ECONOMIES OF SCALE

In any business relationship, trust and experience go a long way to ensure long-term success. And, during an unpredictable economy, when protecting and growing a retirement plan is equally as important to employees as their paycheck, companies must choose and rely on an experienced plan record keeper, and preferably one who offers other human resource solutions.

By engaging one firm that provides a full suite of HR solutions, employees can be given access to one customer service center that may operate on a single, complete database of information. One phone call, in essence, can do it all for an employee with many questions about financial HR benefits. Additionally, the employer benefits from a “one-stop shopping” approach and the related potential economies of scale.

Human capital is a precious commodity and benefits, such as 401(k) plans, go a long way in attracting and retaining the right people. Employers should get answers for the following questions

when choosing a 401(k) plan recordkeeper that offers full disclosure pricing.

- Does the plan record keeper/provider have an agenda for selecting funds, or do they offer an open architecture plan?
- What is the policy and process for replacing an entire fund family, advisor, and/or the plan record keeper?
- Does the plan record keeper offer other complementary administrative and compliance services?
- Are all sub transfer agent fees disclosed and credited to the 401(k) plan? 🌐

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