

# RETIREMENT PLAN FEES

Resource Guide

2nd Edition

## PLAN FEES:

what you need to know in  
today's environment

### COMPONENTS

of retirement plan expenses

### How Dollars Flow

between investment managers,  
plan providers, and participants

### FEE DUE DILIGENCE AND BENCHMARKING

to determine if fees are reasonable

### How New Regulations

impact retirement plans

**Victory**  
Capital Management

## **When It Comes to Managing 401(k) Fees, It's a Jungle Out There**

A jungle indeed: difficult to navigate, rife with hazards, and getting thicker all the time. Defined contribution plan sponsors are facing daunting challenges, especially regarding plan fees. Their responsibilities are complex, and the penalties for missteps can be severe – like being held liable for retirement plan losses attributed to unreasonable fees, including future earnings on those fees, or accountable for civil financial penalties.

Many sponsors don't fully understand these risks, but they cannot afford to ignore the issues surrounding fees paid by retirement plan participants' especially given the current legal and regulatory environment. The Department of Labor and other government agencies are demanding more accountability and disclosure from plan fiduciaries for both direct and indirect fees, making them vulnerable to class-action claims, governmental oversight, and penalties. At the center of these complaints: fees and fee arrangements with service providers.

This guide will:

- heighten your awareness of your fiduciary responsibility to ensure services are necessary and reasonably priced;
- improve your understanding of retirement plan fee components and how they interact;
- offer insights on managing plan expenses through benchmarking, investment selections and the use of consultants; and
- help you keep pace with trends in legislation, regulation and litigation, including new rules requiring more fee disclosure.

While the complexity of fee arrangements can be overwhelming, simple measures can often produce meaningful improvements. For example, plan sponsors can show sensitivity to the reasonableness of fees while also achieving significant savings simply by moving to lower-cost investment vehicles, if available. Understanding plan fees and focusing on the ones that dominate expenses are the keys to success in managing costs.

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# 1

## Retirement Plan Fees: Trends, Challenges, Litigation

The retirement savings marketplace is in the midst of rapid and profound change. New investment options, the impact of market volatility and downturns on retirement accounts, heightened participant awareness of the importance of fees, growing legislative and regulatory attention – all of these changes have combined to present retirement plan sponsors with unprecedented challenges in plan administration.

### Fiduciary responsibilities, with a focus on fees

Of particular concern are retirement plan costs, especially in defined contribution (DC) plans. Fees have a significant impact on participant investment returns, and they can seriously chip away at retirement savings over time.

The Employee Retirement Income Security Act (ERISA) requires that persons responsible for managing retirement plans – known as fiduciaries – act prudently and solely in the best interests of plan participants and beneficiaries. Among other duties, fiduciaries must ensure that **services provided to their plans are necessary and that costs are reasonable.**

Plan sponsors are not required to choose the least expensive options, but they do need to understand who is receiving money – how much and for what services – and whether those costs represent reasonable pricing and

provide good value. In addition, plan sponsors must ensure that participants receive sufficient information to make informed decisions

### The risks are high for fiduciaries who come up short:

- Fiduciaries who fail to establish that they have employed a process designed to assure that fees are reasonable can be held liable for plan losses and for any profits realized through the misuse of plan assets.
- In extreme cases they may incur sizeable civil penalties (maximum of \$100,000 per responsible individual) and face criminal penalties (maximum of 10 years in prison).
- Fiduciaries are also liable for the actions of others associated with the plan if they knowingly conceal a breach or don't attempt to remedy a problem.



### Did You Know?

**Only 72% of plan sponsors who responded to a survey of over 600 small- to large-sized employers said they had performed a detailed fee analysis and had a thorough understanding of all plan expenses.**

Source: "Deloitte Annual 401(k) Survey, 2010 Edition"





### **Why all the focus on DC plan fees?**

The answer lies in the pivotal role defined contribution plans play in retirement savings today. With many defined benefit (DB) plans being frozen and phased out, the future of the nation's retirement savings rests heavily on 401(k) and similar plans. Recognizing this, the government has been compelled to scrutinize the integrity of DC plans in an effort to safeguard participant accounts.

When DC plans came on the scene in the late 1970s, they were intended to serve as a means for American workers to supplement their retirement income; DB plans were the primary source of funds for retirement. And the fee structure of those early DC plans was simple: sponsors typically paid for plan administration and operations, while investment management fees were charged to plan assets and thus paid by participants. In cases where the administration fees were shared, they were often paid as easily understood hard-dollar fees billed quarterly.

Then the landscape began to change. Defined contribution assets grew rapidly during the 1990s, as companies realized the cost to sustain DB plans over the long term. Many employers began offering DC plans to new hires as the primary retirement savings vehicle, while phasing out pension plans. New employers, especially in the private sector, frequently opted to offer only a 401(k).

As DC plans soared in popularity, sponsors turned increasingly to mutual funds as the investment product. Unlike vehicles such as collective trust funds, mutual funds were built to handle daily valuations and large-scale client

service demands. Many fund families had become household names and garnered public trust. Simply put, mutual funds were a good fit, and they rapidly began to dominate DC platforms.

At the same time, fund managers started offering bundled services to DC plans, including administration and recordkeeping, at little or no extra direct cost to the plan sponsor. Technological advances permitted DC platforms to offer a variety of investment options from multiple fund families. All of this resulted in more complex fee structures between service providers. These more subtle arrangements often were not completely understood by plan sponsors, let alone participants, who had begun to pay nearly all plan expenses.

The role of DC plans in retirement savings today will become even more dominant in light of the worsening outlook for Social Security. According to the Congressional Budget Office, Social Security's outlays exceeded tax revenues in 2010 as a result of demographics and the recession, far earlier than previously estimated. Projections that Social Security trust funds will not be exhausted until 2037 may be highly optimistic unless significant changes are made. Future retirees will depend more and more on the balances they have been able to accumulate in their 401(k) accounts – and the balances in those accounts are greatly impacted by the fees that have been paid out of those accounts over the life of the account. The importance of DC plans and the assessment of the reasonableness of fee arrangements by the plan sponsor means that careful attention to the fee arrangement will be given – by regulators and litigators.

## On the legal front, no one is immune

**Question:** What do Lockheed Martin, General Dynamics, United Technologies, Bechtel, Caterpillar, International Paper, Unisys, Deere, Cigna, and Northrop Grumman have in common?

**Answer:** Each has been the subject of 401(k) fee litigation.

Dozens of the nation's largest companies have been defendants in class-action lawsuits alleging fiduciary breaches for excessive fees. While the specifics of each case vary, the suits are generally based on the broad fiduciary duties prescribed by ERISA and focus on three specific areas:

### Revenue sharing as compensation for DC plan service providers

Revenue sharing occurs when an investment manager, recordkeeper or other service provider agrees to share a portion of its revenues with others to offset plan sponsor administration fees. Plaintiffs complain that fiduciaries have not properly investigated and accounted for these revenue-sharing payments when negotiating with service providers. As a result, they contend, total plan costs are unreasonable and fiduciaries have violated their ERISA duties.

### Inadequate disclosure of fees paid by participants

In addition, plaintiffs argue that fiduciaries have failed to communicate the details of shared fee arrangements to participants, a breach of the sponsor's disclosure duties under ERISA.

### Failure to use lower-cost investment vehicles available to the plan

Many DC plans begin with retail mutual funds in their investment lineup. As assets grow, plans may become eligible for lower-cost share classes and less expensive products such as collective trust funds and separately

managed accounts. Complaints surface when participants believe fiduciaries have permitted fees to become excessive by failing to negotiate changes in share classes or switch to less expensive investment options.

The results of legal actions have been mixed. The courts found in favor of Deere, ruling ERISA does not mandate that plans disclose revenue-sharing agreements and rejecting the assertion that investment vehicles in the plan were too expensive. But in November 2009, after three years in court, Caterpillar Inc. announced it had reached a tentative \$16.5 million settlement in a class-action suit alleging 401(k) participants were overcharged.

The bottom line? Legal precedent offers no shield. It's clear that the courts are looking at the specific circumstances of each case – and that means fiduciaries will continue to be vulnerable.



## Direct vs. Indirect Fees

The DOL issued Advisory Opinion 97-16A in 1997 emphasizing its view that plan fiduciaries must obtain sufficient information regarding both the direct and indirect compensation received by service providers, and make informed decisions about whether that compensation is reasonable.

## Full-court press

Lawsuits are forcing debates about fee transparency and whether retirement plan participants are being overcharged. So far, the results are mixed. Here are some key cases:

Case	Issues
<i>Hecker v. Deere</i>	<p><b>Complaint</b> Plaintiffs claimed Deere and Fidelity (with whom Deere had entered into a bundled 401(k) plan) breached their fiduciary duties under ERISA by failing to disclose revenue-sharing arrangements to plan participants and allegedly causing the plan to overpay for bundled services.</p> <p><b>Ruling</b> Court ruled in favor of Deere:</p> <ul style="list-style-type: none"> <li>• Participant disclosure reflected total expenses for fund management and met existing requirements</li> <li>• DOL's ongoing review of revenue-sharing arrangements confirmed disclosure of these arrangements was not presently required</li> <li>• A variety of investment alternatives with different cost structures were available to participants</li> </ul>
<i>Martin v. Caterpillar</i>	<p><b>Complaint</b> Plaintiffs claimed fiduciaries:</p> <ul style="list-style-type: none"> <li>• Failed to fully disclose revenue-sharing arrangements</li> <li>• Did not consider/capture additional revenue streams</li> <li>• Chose not to use actively managed mutual funds</li> <li>• Chose to use mutual funds (higher cost) rather than separate accounts</li> <li>• Improperly benefited from the sale of investment management subsidiary</li> </ul> <p><b>Settlement</b> Caterpillar agreed to pay \$16.5 million to settle the case. After payment of legal fees, the net proceeds will be paid into participants' 401(k) accounts. More importantly, Caterpillar agreed to make changes to its DC plan. The company will:</p> <ul style="list-style-type: none"> <li>• Limit fees charged to participants, with such fees calculated on a flat fee or per participant basis</li> <li>• Not allow investment consultants to also serve as investment managers or receive compensation from plan investments</li> <li>• Increase communications with employees about investment options and fees</li> <li>• Have an independent trust company monitor the plans</li> <li>• Not include retail mutual funds as investment options</li> <li>• Undertake competitive bidding when contracts are up for renewal</li> </ul>
<i>Tibble v. Edison International</i>	<p><b>Complaint</b> Plaintiffs filed a class-action suit against several different Edison entities and fiduciaries alleging prohibited transactions, fiduciary breaches and excessive plan fees.</p> <p><b>Ruling</b> Court dismissed most claims, but ruled the selection of retail share classes without investigating less-expensive institutional shares of three mutual funds resulted in excessive fees. Importantly, the court did not accept as a defense plan sponsor's reliance on an investment consultant's recommendations. Court ruled damages are to be calculated from 2002 to time of decision for each of the funds.</p>
<i>Taylor v. United Technology Corp.</i>	<p><b>Complaint</b> Plan participants filed a class-action suit claiming the plan should not have offered actively managed funds because they generally don't outperform passive funds. Also claimed that fiduciaries did not consider/capture float and that there was a fiduciary breach in failure to disclose revenue sharing and that revenue sharing led to excessive fees.</p> <p><b>Ruling</b> Court ruled against plaintiffs; U.S. Appeals Court affirmed ruling.</p>

## Is Section 404 (c) a safe harbor in the litigation storm?

By following the guidelines set forth in Section 404(c) of ERISA, a fiduciary may shift some of the responsibility for investment decisions to the participant. The thrust of these guidelines is this...

...if the plan offers participants a sufficient range of prudent investment choices and enough flexibility to reallocate among those investments, and

...if participants receive sufficient and timely information to make prudent investment decisions, then

...the plan sponsor enjoys protection from liability for investment losses incurred because of decisions made by participants.

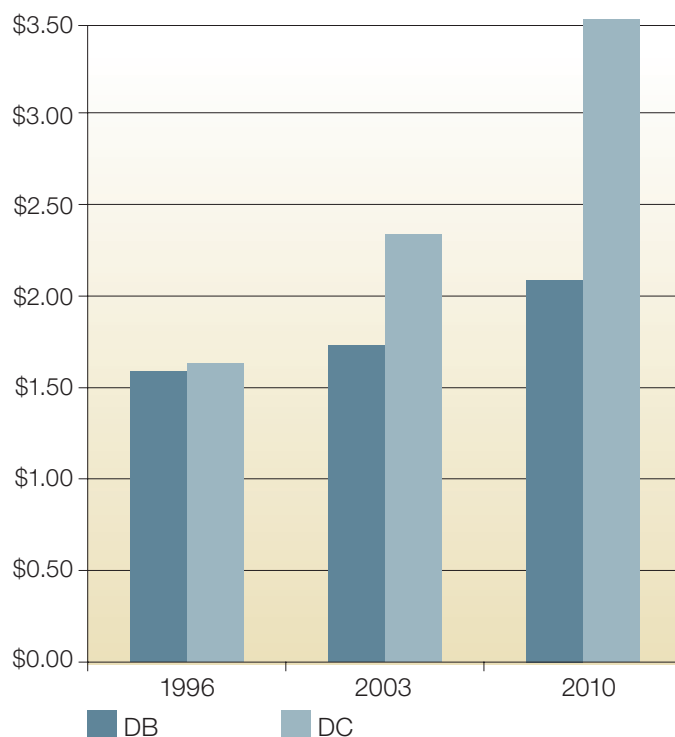
While Section 404(c) provides some protection, fiduciaries are still responsible for the prudent selection and oversight of the investment vehicles offered and all parties involved in the plan. They also are responsible for incurring only necessary and reasonable expenses in administering the plan.

So this “safe harbor” is not deep enough to excuse plan sponsors from claims of excessive fees.

“Whether the fees that 401(k) plans charge are fair or reasonable is a vital issue for working Americans and their families. The role of 401(k) plans in financing retirement eclipsed some years ago the role that traditional defined benefit plans used to play, and that role continues to grow.”

Source: AARP

**U.S. Private-Sector Retirement Assets**  
(\$ in trillions)



Source: Federal Reserve, Flow of Funds, 1996–2010

By 2010, DC assets surpassed DB assets by \$1.4 trillion.

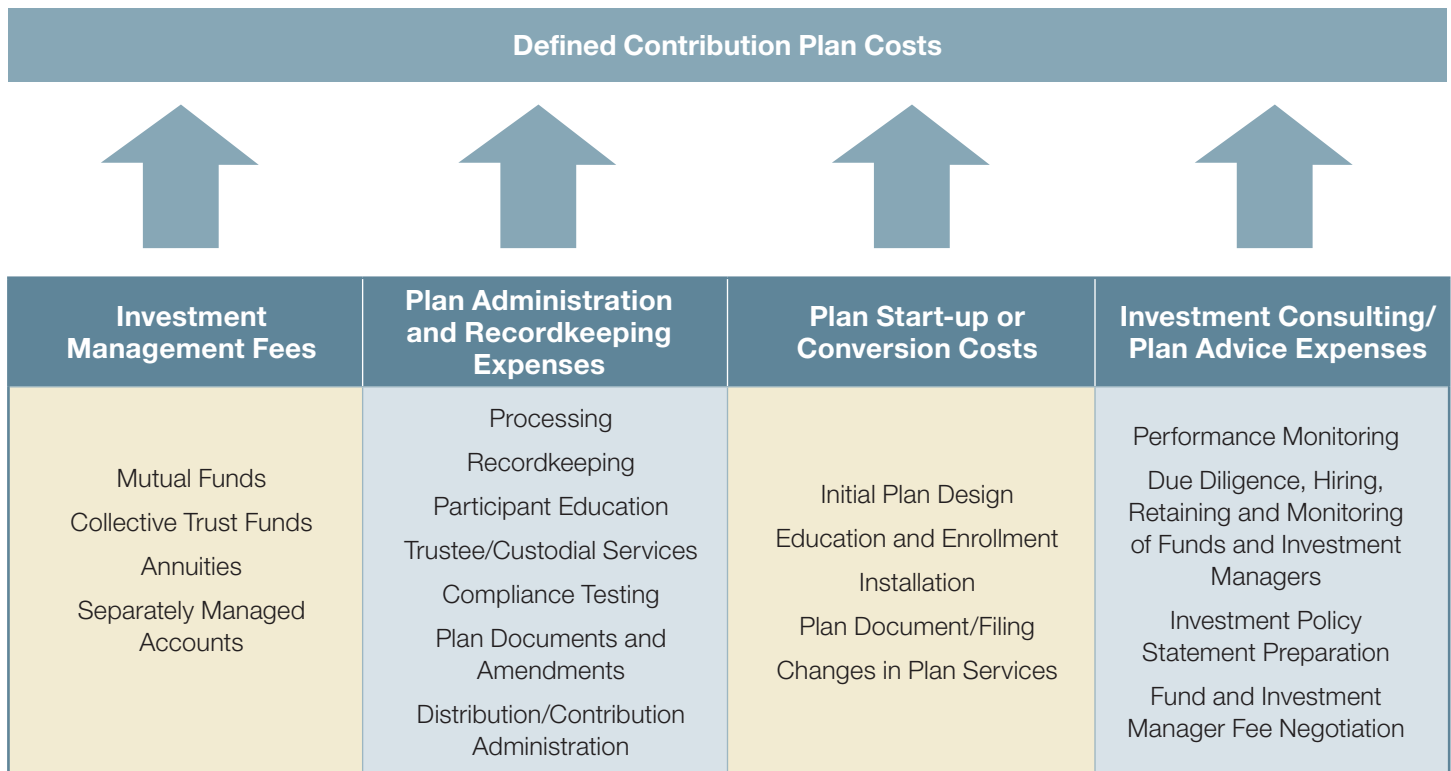




# 2

## Cost Components and Comparisons

It's important that plan sponsors understand all of the components that make up their total plan cost – what services are provided, how plan fees are structured, who pays what to whom. While many different fee and service arrangements exist, defined contribution plan costs can be broken down into four major categories: investment product, plan administration and recordkeeping, plan start-up or conversion, and investment consulting advice.



### Investment consultants add value

Investment consulting/plan advice expenses represent a set of valuable plan services, especially since they provide a record of the due diligence process engaged in by plan fiduciaries. Effective investment consulting should result in:

- The selection of prudent investment choices.
- A menu of investment options that makes sense for the plan based on its investment policy.
- Fee and revenue-sharing arrangements with fund managers that make sense from a fiduciary perspective.

Be careful to examine consultant relationships for potential conflicts of interest. Ask questions: How is the consultant being paid? Is the consultant related to the investment advisor for the vehicle being recommended? If so, make sure there are no financial incentives in the arrangement that would cause the decisions of the investment manager or consultant to be called into question.

## Focus on Investment Fees – Because They Dominate DC Plan Expenses

While every cost counts, one thing is the same for all plans: Fees for managing the investment portfolios account for the vast majority of expenses – often exceeding 90% of total plan costs.

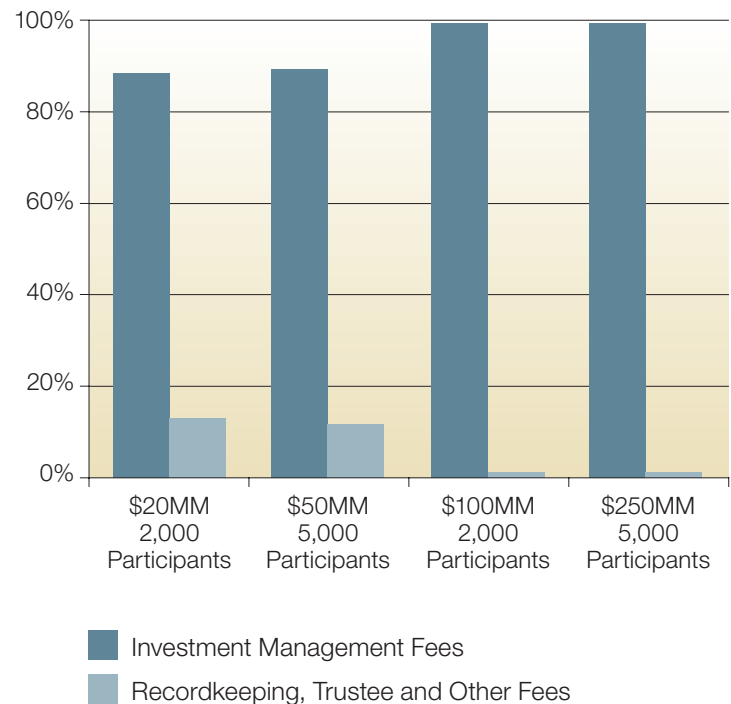
## And for the Most Part, Participants Pay Those Investment Fees

Usually charged as a fixed percentage of assets and deducted from investment returns, investment fees are typically borne by participants, which is why they get so much attention from regulators. According to a study published in 2006 (Government Accountability Office and the Profit Sharing/401(k) Council of America), 401(k) plan participants paid all investment fees in almost 62 percent of plans with 5,000 or fewer members. This arrangement was even more prevalent in plans with over 5,000 members, where participants paid all investment fees in about 71 percent of the plans. The study also found that sponsors and participants shared investment fees in an additional 10 percent to 12 percent of plans.

Not surprisingly, participants bear the bulk of DC expenses. Based on a study by Deloitte, participants pay the vast majority of fees in all plan sizes (through expenses charged to underlying investments), with participants in plans of \$10 million or more in assets paying a larger share than those in smaller plans.

## Investment Fees Drive 401(k) Plan Costs

### Percentage Cost by Plan Size



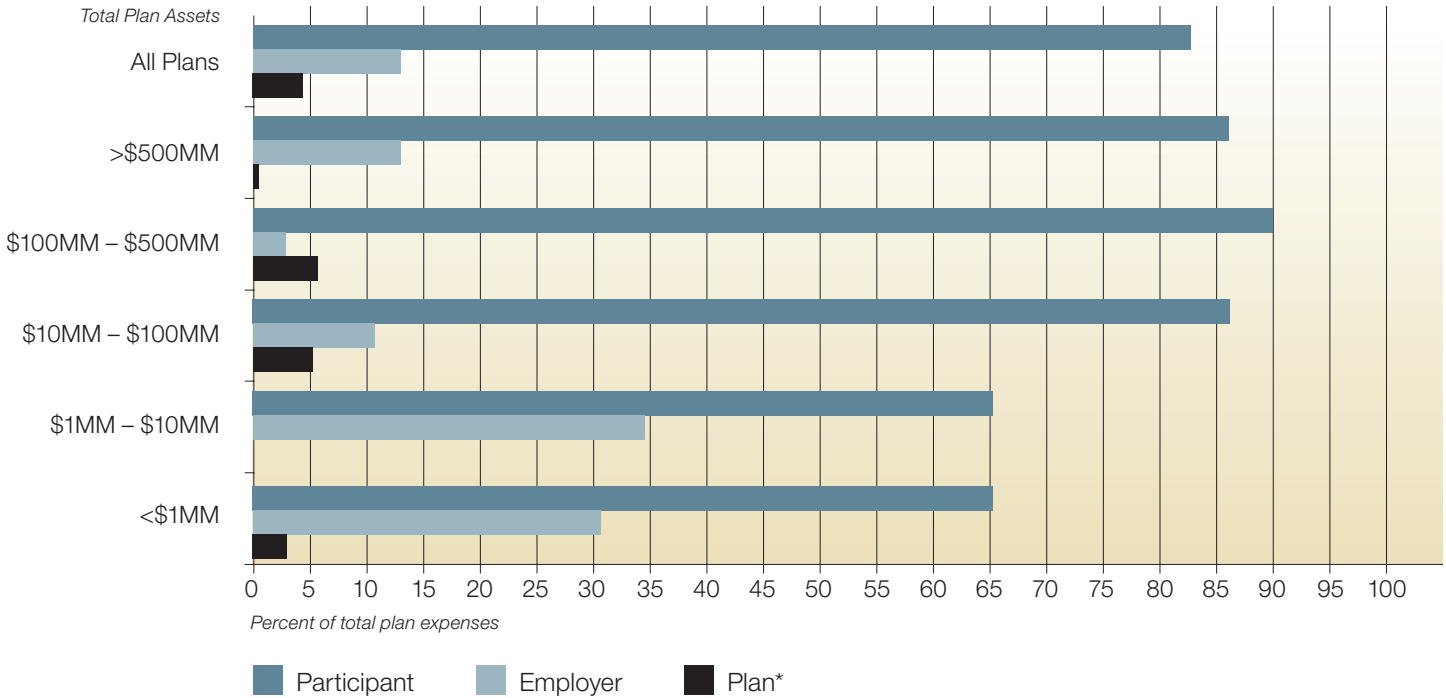
Source: 401k Averages Book, 11th Edition, 2010

## To Bundle or Unbundle? *That* is the Question.

**Generally, there are two ways service providers work with DC plan sponsors. In bundled arrangements, the sponsor hires one company to provide a full range of investment, recordkeeping, administration and education services, directly or through subcontractors. In unbundled structures, the sponsor selects separate service providers for each task.**

**The range and types of services available to you and your participants can vary widely in bundled and unbundled structures. It's important to understand the details of each vendor arrangement. Determining whether bundling makes sense for your plan requires a full accounting of plan revenue and expense flows, how service providers are paid, and who pays them.**

## Payer of All-in 401(k) Fees



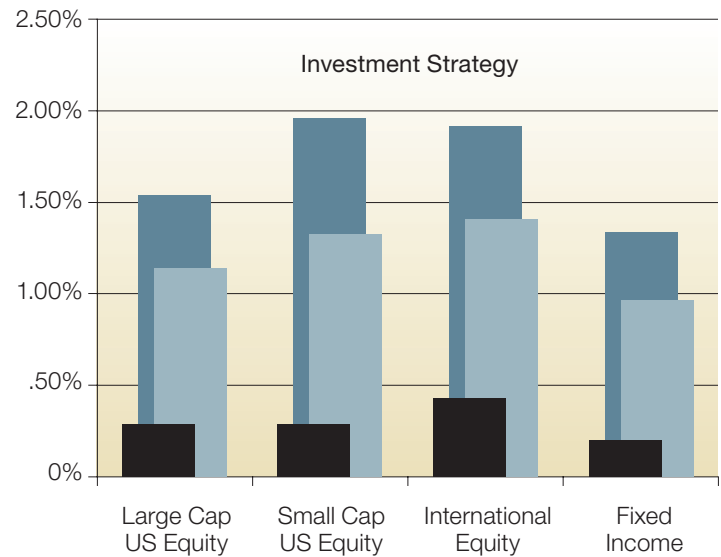
\*Primarily achieved through forfeited employer contributions  
 Source: Deloitte "Defined Contribution/401(k) Fee Study, 2009"

## What Participants Pay Depends on the Investment Options Offered

When DC plans were introduced in the late 1970s, the range of investment choices was relatively small. Today, plan sponsors can choose from a wide range of investment strategies, vehicles and providers, all with varying costs. Coupled with the fact that participants pay most of those costs, the job of selecting and monitoring plan investment options has become more difficult – and much more important.

High Cost ■  
 Average Cost ■  
 Low Cost ■

## The Cost of Investment Vehicles Available to a Plan Can Vary Dramatically



Average plan with \$50MM in assets and 1,000 participants

Source: 401k Averages Book, 11th Edition, 2010



## Revenue Sharing, 12b-1 Fees and Sub-Transfer Agency Fees

Revenue sharing occurs when investment providers pay other plan service providers for product distribution or recordkeeping/administrative services.

Revenue sharing can be based on:

- a percent of assets (distribution or 12b-1 fees) or
- a flat dollar amount per participant (sub-transfer agency fee).

Both methods may be included in a revenue-sharing agreement. The payments are made by the shareholder (out of fund assets) and/or by the investment manager.

*Distribution (12b-1) fees* are sales and marketing charges. In DC plans, these fees are paid by funds to financial advisors for retirement plan services, including assistance in selecting and monitoring funds, communications, investor education and related services.

*Sub-transfer agency fees* represent a portion of transfer agency compensation for DC plan recordkeeping services paid to trust companies, third-party administrators or banks. Because mutual fund companies do not need to account for shareholder balances, they pay plan administrators a fee for performing this service on their behalf. These fees can be paid out of the fund (other expense category) or by the investment advisor from its investment management fee revenue. Collective funds can pay these fees as well for participant-level recordkeeping functions.

When any of these fees are paid, plan sponsors should evaluate whether they relate to services provided to the plan and whether other investment options with lower fees are available.



## Is Cheaper Better?

There is no requirement that plan fiduciaries select the least expensive investment options. Higher-cost vehicles using the same investment strategy may generate returns that more than offset their fees. In some cases, the least expensive mutual fund share class or collective trust fund might not be available due to required minimum investments or other restrictions, or it might not be appropriate for a particular plan.

In addition, offering diverse choices can involve asset classes with higher expenses. For example, an international equity fund requires more research and operations support driving operating expenses higher than for a large-cap domestic equity fund. Similarly, trading in less liquid markets, like small caps, can result in higher costs that are passed on to the investor.

While there are thousands of investment strategies and choices available in the DC plan market, most fall into one of four investment types: Mutual Funds, Annuities, Collective Trust Funds, and Separately Managed Accounts.

## Investment Types

Feature	Mutual Funds	Annuities	Collective Trust Funds	Separately Managed Accounts
Portfolio Composition	Pooled	Pooled	Pooled	Individually managed
Fees	All investors in a given share class pay fund's expense ratio taken at the mutual fund level	Fees are associated with underlying mutual fund or investment offering plus annuity contract fees	Fees are flexible and vary by plan	Fees are flexible and vary by plan
Range of Asset Classes Available	Broadest universe of asset classes	Wide range of asset classes and choices, but more limited than mutual funds	Wide range of asset classes and choices, but more limited than mutual funds	Wide range of customized options, but more limited than mutual funds
Annuity/Insurance Features	No	Yes	No	No
Valuation	Daily	Daily	Daily increasingly prevalent; quarterly is required by regulation	Typically valued daily
Accessibility of Performance Information	Readily available to plan sponsor and participant	Less readily available, especially at participant level	Less readily available, especially at participant level	Less readily available, especially at participant level
Availability	Available to general public (not ERISA exclusive)	Distributed by insurance companies	Not available to general public (ERISA exclusive)	Not typically available to general public

Investment fees often are determined by whether a fund is actively or passively managed.

- **Actively managed** funds have higher fees because the fund manager actively researches, monitors, and trades the holdings of the fund in an effort to net a higher return than the market as a whole.
- **Passively managed** funds have lower fees because the fund manager is only seeking to obtain the investment results of an established market index, such as the S&P 500.

Generally, providers that charge higher fees are likely to be offering services that justify the cost. It's not a matter of cheapest, it's a matter of reasonable: offering a good value and diverse choices.

## Mutual Funds, the Dominant Player

Mutual funds are the most common investment vehicle used by DC plans. Included in over 90% of all plans, over half of the \$2.8 trillion in 401(k) plan assets are held in mutual funds.

- Mutual fund companies may provide a multi-class share structure to pay for the advisory and shareholder services offered to different types of investors in the same portfolio of securities. For DC plans, the most common are R, A and I class shares, each tailored to the requirements of different DC plan sizes.
- Because R and A class shares typically carry distribution (12b-1) and sub-transfer agency fees to fund the servicing needs of small- and mid-size plans, operating expenses tend to be higher than for the I class shares used in large and mega plans.

### Did You Know?

**Institutional (I) share class mutual funds represented 40% of total 401(k) mutual fund assets in 2009, up from only 16% in 1996.**

Source: Investment Company Institute, 2010

## Annual Impact of Fees for Different Mutual Fund Share Classes

### Example – Large Cap Funds

Share Class	Portfolio Management Fee	Distribution (12b-1) Fee	Other Expenses		Total Expense Ratio
			Sub T/A Fee Admin/Opns	Other	
I	0.50%	0.00%	0.00%	0.20%	0.70%
A	0.50%	0.25%	0.25%	0.20%	1.20%
R	0.50%	0.50%	0.25%	0.20%	1.45%
C	0.50%	1.00%	0.50%	0.20%	2.20%

Revenue sharing is complex and can come from all mutual fund components, depending on plan design.

### Did You Know?

**Trading costs are not included in mutual fund operating expense ratios and are charged directly against asset values as trades are made. Portfolios with higher turnover incur higher transaction costs than those with low turnover – so dig deeper into what the true operating expense is. This information is not included in a fund’s prospectus, but may be found in its Annualized Audited Report (in the Financial Highlights section).**

## Collective Trust Funds, Less Expensive Than Mutuals

A collective trust fund (CTF) is a tax-exempt, pooled investment vehicle administered by a bank or trust company that is available to defined benefit and defined contribution plans. While CTFs were at one time largely stable value or passive investments, today they offer a full assortment of equity and fixed income asset classes and styles and appear on almost 31% of DC platforms.

- Unlike mutual funds, CTFs are designed specifically for qualified plans, and do not bear the expenses associated with servicing large numbers of retail clients.
- In addition, since CTFs are exempt from registration with the Securities and Exchange Commission, they do not experience the costs associated with registration that mutual funds have and they avoid the expenses mutual funds incur for board meetings and preparing and distributing proxies, prospectuses and Statements of Additional Information.
- CTFs are suitable for large rather than small plans. They feature flexible pricing structures, unlike mutual funds, which have fixed management and servicing fee schedules. This flexibility means CTFs can offer lower pricing to plan sponsors with more assets under management – a major reason why large plans find CTFs to be an attractive option.

On average, CTFs have significantly lower fees than mutual funds, an advantage most pronounced for larger plans that, for reasons of scale, have access to the best pricing.

## DC Plan Fees Are Typically Calculated in One of Four Ways

Fee Type	Charges Based On:	Examples
Asset-based	Amount of plan assets are typically expressed as percentages or basis points	Investment expense, contract/annuity fee
Per-person	Number of participants in plan or number of eligible employees.	Start-up, education and enrollment fees
Transaction-based	Execution of particular plan service or transaction	Loan origination fee, distribution expense
Flat rate	Fixed charge that does not vary	Annual audit fee

## Institutional Separately Managed Accounts, Often the Least Expensive Option

Institutional separately managed accounts (SMAs) are professionally managed portfolios of securities that are owned directly by the account holder. SMA portfolios differ from those of CTFs or mutual funds, which are pooled investment vehicles.

- SMAs are often the lowest-priced alternative compared to mutual funds or CTFs employing the same investment strategy.
- Since performance is reported for each account, fact sheets cannot be produced and shared with plan participants.

Popular in the public market, SMAs have gained acceptance by some retirement plans. SMAs are typically used with the largest plans in terms of assets, appearing today on 20% of DC platforms. To reach the lowest price breaks for most investment managers, the size of the fund must be significant.

## Did You Know?

**Collective trust funds (CTFs) are becoming an increasingly attractive option for large-market DC plans. For starters, today's CTFs are more flexible, more transparent, more accessible, delivered more efficiently and available in a wider range of investment styles than ever before. But their growing popularity is driven mostly by an increased focus on plan expenses, in large part due to heightened legal and regulatory scrutiny of fees and costs.**

## Annuities, A Way to Offer Some Guarantees<sup>1</sup>

Annuity investment products offered by insurance companies are widely used in retirement plans, with plan assets frequently packaged on a group annuity platform. A group variable annuity contract wraps around the plan's investment options, which can include investment options and separate account portfolios, and fees are wrapped into an overall charge. The participant has a pooled investment account with a contract that has insurance-related elements and charges, including those for an annuity feature, interest and expense guarantees, and any death benefit provided during the contract term.

Fees and expenses are assessed at two levels. The first is for investment management, similar to the fees paid by participants in non-annuity programs. The second set of "wrap" fees includes:

- Charges for investment consulting and commissions.
- Insurance-related charges – sales expenses, mortality risk charges and the cost of issuing and administering contracts.
- Surrender and transfer fees – may be assessed when an employer terminates a contract early and transfers the assets to another investment vehicle.
- Recordkeeping fees – may be included in certain plans. Annuities may also be offered to plan participants in individual account form alongside mutual funds, CTFs and SMAs as part of a NAV-based platform. Annuities are included in approximately 5% of DC platforms.

<sup>1</sup> Based on the claims-paying ability of the guarantor.

## Key Takeaways and Action Items

- **Investment product fees are far and away the largest part of plan costs and are typically paid by participants.**
- **Plan sponsors need to understand the fee structures of the investment vehicles available to participants compared to other options, especially options that offer the same investment strategy at a lower cost.**
- **Access the revenue-sharing agreements to determine how the various service providers are being paid and how much each gets for the services provided.**

## Settlor vs Non-Settlor Expenses – Who Pays?

The DOL recognizes a separate category of expenses called "settlor" expenses. These are costs associated with the establishment of ERISA plans. Generally, settlor expenses must be paid by the plan sponsor and not from plan assets or revenue, while non-settlor activities generally may be paid from plan assets.

### Settlor Functions

- Plan design study
- New plan design
- Establishing a plan
- Discretionary plan amendments (not legally mandated)
- Filing for an IRS determination letter for nonlegally mandated reasons
- Correction of compliance and fiduciary errors
- Penalties for late Form 5500 filing
- Union negotiations
- Cost projections to assess the impact of plan changes on the employer
- Legal and consulting fees associated with plan termination
- Asset/liability forecasting related to plan design or financial accounting measures

### Non-settlor Functions

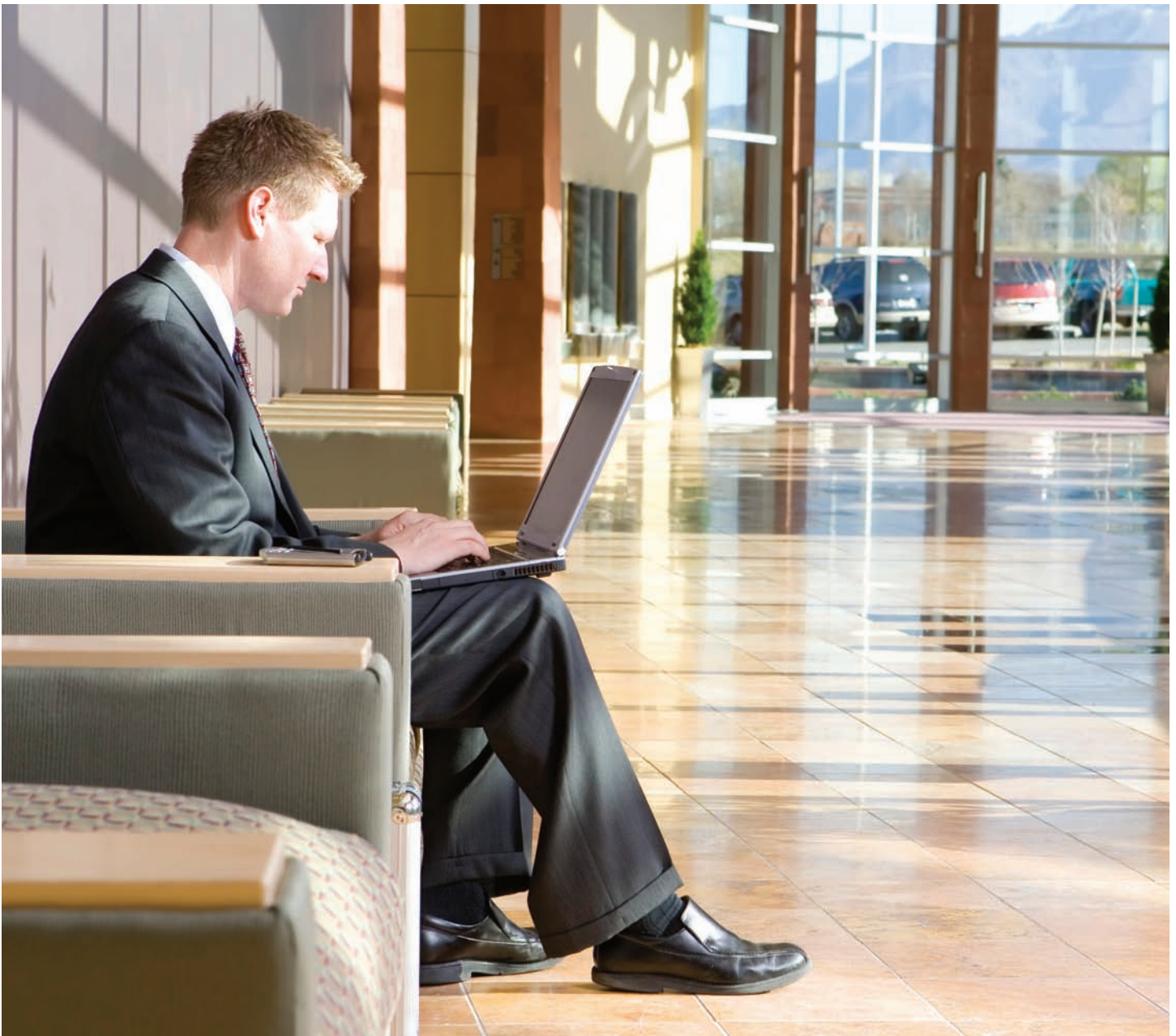
- Plan amendments required by law
- Implementing changes in plan operations resulting from an amendment
- Benefit calculations
- Nondiscrimination testing for tax qualification
- Fiduciary liability insurance
- IRS determination letter request (mandated)
- Distributing benefit statements and required disclosure materials
- Obtaining an ERISA bond or fiduciary liability insurance
- Starting up and performing ongoing plan administration services, including recordkeeping, communications and custodial services
- Performance reporting and manager searches
- Investment-related services

Source: SPARK's Education Center and "Understanding Current Retirement Plan Fee Issues" and Bryan Cave "ERISA Plan Expenses – Who Pays"



# 3

## Plan Objectives and Revenue Sharing: How the Dollars Flow



## Objectives Impact Investment Structure

There is no one-size-fits-all methodology or model for implementing a plan. Sponsors usually evaluate specific objectives, and fees are always a critical component in the evaluation process. One of the most common objectives is for all plan expenses to be paid from revenue-sharing arrangements, which are deemed reasonable, with no additional out-of-pocket costs to the sponsor or participants.

Plan Structure	Objective	Considerations
Investment fund revenue sources pay for all plan operating expenses	No out-of-pocket costs for plan sponsor or participants	<ul style="list-style-type: none"> <li>• Reasonable revenue-sharing arrangements are constructed to offset plan expenses</li> <li>• Ensure fee transparency and detailed disclosure</li> <li>• Maximize readiness of plan participant for retirement</li> </ul>
Maximize employee participation	Maximize individual contributions and overall participation levels	<ul style="list-style-type: none"> <li>• Wide range of investment alternatives, including target date funds<sup>2</sup></li> <li>• Auto-enrollment</li> <li>• Leading-edge technology to enhance participant experience</li> <li>• Emphasis on participant communications</li> <li>• Qualified Default Investment Alternatives (QDIA)</li> <li>• Company match</li> </ul>
Maximize ease of recordkeeping and administration	Comprehensive recordkeeping and administrative services	<ul style="list-style-type: none"> <li>• Bundled plan vs. unbundled program</li> <li>• Use of retirement plan consultant to structure and manage plan</li> <li>• Need for expense and revenue-sharing transparency</li> <li>• Frequent use of platform resources</li> </ul>
Meet participant needs for investment options	Design platform of investment options that meet participant needs for high-quality investment options and diversification at a reasonable cost	<ul style="list-style-type: none"> <li>• As plan assets increase, different pooled investment styles available to plan sponsor that can reduce investment fees</li> <li>• Broaden the range of asset classes available, including target date funds</li> <li>• Assess recordkeeper's ability to support different types of investment products</li> <li>• Consideration of self-directed brokerage accounts or SMAs</li> </ul>
Support by investment advisor/consultant	Strengthen investment oversight process, due diligence and monitoring by advisor/consultant	<ul style="list-style-type: none"> <li>• Review of investment performance net of fees</li> <li>• Review of investment vehicles</li> <li>• Review of revenue sharing arrangements and ferreting out conflict situations</li> </ul>
Emphasize comprehensive participant education and communication	Customize education and communications to meet specific participant needs and regulatory requirements	<ul style="list-style-type: none"> <li>• Utilization of non-mutual fund options may require additional plan participant education</li> <li>• Participant familiarity with investment vehicles in plan</li> <li>• Develop customized education programs</li> <li>• Fee disclosures and transparency</li> <li>• Multiple communications media</li> </ul>

<sup>2</sup> Target date funds' objectives and investment strategies will change over time and the principal value is not guaranteed at any time. In addition, investors in target date funds will be required to select an approximate date upon which to withdraw funds.

## Follow the Money – (Hypothetical Example)

Examining a sample plan, and following the math step-by-step, will help illustrate how dollars flow between various entities. This sample plan features the common objective of having plan revenue pay all costs, with no hard-dollar fees paid by the sponsor or participants.

### Sample Plan – XYZ Client

Plan Objective: No out-of-pocket cost for plan sponsor or participant

Total Plan Assets:	\$10,000,000
Investment Lineup:	Predominantly Mutual Fund A-Share Classes
Participants:	350
Administrative and Recordkeeping Fee:	\$12,500
Broker Compensation:	Commission-based payment from the mutual fund 12b-1 fees

The complete revenue and expense statement for the XYZ Plan is shown below:

### XYZ Plan Expenses and Fee Credit Analysis

Fund Name	Fund Balance	Plan Participants	Expense Ratio	Net Fund Expense	12b-1 Fee	Shareholder Servicing	Sub-TA Fee Credits	Total Revenue Credit
Large Cap Growth Fund	\$1,000,000	175	0.0133	\$13,300	0.0025	0.002	\$ 875	\$5,375
S&P 500 Fund	\$2,000,000	275	0.0059	\$11,800	0	0.001	\$1,375	\$3,375
Large Cap Value Fund	\$1,750,000	200	0.0123	\$21,525	0.0025	0.002	\$1,000	\$8,875
Mid Cap Growth Fund	\$ 250,000	125	0.0162	\$ 4,050	0.0025	0.002	\$ 625	\$1,750
Mid Cap Core Fund	\$ 350,000	200	0.0144	\$ 5,040	0.0025	0.002	\$1,000	\$2,575
Mid Cap Value Fund	\$ 400,000	100	0.0135	\$ 5,400	0.0025	0.002	\$ 500	\$2,300
Small Cap ABC Fund	\$ 700,000	150	0.0140	\$ 9,800	0.0025	0.002	\$ 750	\$3,900
International Large Cap Fund	\$ 650,000	125	0.0150	\$ 9,750	0.0025	0.002	\$ 625	\$3,550
Intermediate Bond Fund	\$ 530,000	250	0.0094	\$ 4,982	0.0015	0.002	\$1,250	\$3,105
Stable Value Fund	\$1,700,000	120	0.0075	\$12,750	0	0.002	\$ 600	\$4,000
Target Date 2020	\$ 70,000	15	0.0114	\$ 798	0.0025	0.002	\$ 75	\$ 390
Target Date 2030	\$ 150,000	25	0.0118	\$ 1,770	0.0025	0.002	\$ 125	\$ 800
Target Date 2040	\$ 300,000	25	0.0120	\$ 3,600	0.0025	0.002	\$ 125	\$1,475
Target Date 2050	\$ 150,000	5	0.0122	\$ 1,830	0.0025	0.002	\$ 25	\$ 700
	\$10,000,000			\$106,395	\$15,220	\$18,000	\$8,950	\$42,170

Total Annual Recordkeeping and Reporting Fee	\$12,500
Annual Investment Advisor Fee (flat dollar)	\$ -
Annual Investment Advisor Fee (asset-based fee)	\$15,220
Total Annual Recordkeeping, Reporting and Investment Advisor Fees	\$27,720
Less: Total Revenue Credit Offset	\$(42,170)
<b>Annual Net Plan Credit (or Annual Additional Fee Due)</b>	<b>\$14,450</b>

## Step 1

### Expenses of a Single Mutual Fund on the Platform

A good first step in understanding total plan revenue and expense is to look at a typical fund in the XYZ plan.

#### Small Cap ABC Fund Fee Analysis (from chart on previous page)

A Class Shares Expense Example		
Management Fee	0.80%	<ul style="list-style-type: none"> <li>• 0.60% retained by Small Cap ABC investment manager</li> <li>• 0.20% paid to recordkeeper (shareholder servicing)</li> </ul>
Distribution (12b-1) Fees	0.25%	<ul style="list-style-type: none"> <li>• Paid to dealer of record for sales and marketing support by a commission-based financial advisor</li> </ul>
Other Fees	0.35%	<ul style="list-style-type: none"> <li>• \$5 per participant paid to recordkeeper (Sub-T/A fees)</li> <li>• Remainder retained by Small Cap ABC Fund</li> </ul>
<b>Total Operating Expenses</b>	<b>1.40%</b>	

Management Fee (0.80%)		Distribution (12b-1) Fee (0.25%)	Other Fee (0.35%)	
\$700,000 @ 0.80% = \$5,600		\$700,000 @ 0.25% = \$1,750	\$700,000 @ 0.35% = \$2,450	
Retained by Small Cap ABC Fund for investment manager (0.60%)	Paid to recordkeeper for shareholder servicing (0.20%)	Paid to dealer of record	\$5 per participant paid to recordkeeper (Sub T/A Fees)	Retained by Small Cap ABC Fund
\$4,200	\$1,400	\$1,750	\$750	\$1,700
<b>Total Small Cap ABC Fund Expenses Paid by Plan Participants = \$9,800 (1.40% of \$700,000)</b>				

Next, translate these percentages into dollar terms for the Small Cap ABC Fund:

Total Plan Assets Invested in Small Cap ABC Fund – \$700,000

Total Plan Participants in Small Cap ABC Fund – 150



## Step 2

### Understanding the Total Revenue Credit

In this example, Small Cap ABC Fund retains \$6,110 in revenue (\$4,410 management fee + \$1,700 in other fees) and the dealer of record is paid \$1,750 (12b-1 fees). The remaining revenue of \$2,150 represents revenue sharing, which may be used by plan providers to offset plan fees such as recordkeeping and other plan charges. The amount of the 12b-1 and other revenue sharing is shown as a Total Revenue Credit in the XYZ Plan.

Who	What	How Much
Dealer of Record	Distribution and marketing (12b-1) revenue paid to Financial Advisor's dealer, a percentage of which is paid to the broker of record	\$1,750
Recordkeepers	Revenue shared with recordkeepers to offset fees associated with plan administration	\$1,400 Shareholder Servicing \$ 750 Sub T/A Fees \$2,150
Total Revenue Credit	\$3,900 or 56 basis points	39% of total expenses

### Who gets 12b-1 revenue?

**A recordkeeper can also be paid from a 12b-1 pool. If the recordkeeper receives a payment from a 12b-1 pool, it may be used to offset administration fees or paid to a financial advisor for servicing the plan.**

## Step 3 and Step 4

### Total Revenue Credit and Expenses for XYZ Plan

Adding the revenue-sharing dollars produced by 12b-1, shareholder servicing and sub T/A features for all funds in the XYZ Plan produces a Total Revenue Credit of \$42,170. As mentioned earlier, this credit represents the amount available to offset other plan costs. In the XYZ Plan example, the other fees total \$27,720 and are composed of recordkeeping/administration costs (\$12,500) and investment advisor commission fees (\$15,220).

***Since the Total Revenue Credit of \$42,170 exceeds recordkeeping/administration costs and investment consulting fees, the XYZ Plan meets the objective of having plan revenue pay for plan operating costs.***

If you've done a good job, the Total Revenue Credit should approximate total plan fees. If you end up with excess credits, consider the following:

- Find a share class of funds with lower expenses or revenue-sharing arrangements.
- Use any excess credit to pay for additional participant education programs or to enhance other participant materials (such as information on plan investment options or other aspects of retirement planning).

## Making Decisions about Plan Services and Fee Arrangements

While the XYZ plan design described is fairly common, there can be variations in expense and compensation structures. Consider the same plan with the following changes:

Institutional share class mutual funds are used instead of A share class mutual funds.

Total revenue sharing is through shareholder servicing (10 basis points) with no 12b-1 or sub T/A fees.

Administrative and Recordkeeping Fees remain at \$12,500.

Investment consultant charges a flat fee of \$25,000.\*

How does the new arrangement work out in terms of paying plan costs?

### XYZ Plan Expenses and Estimated Fee Credit Analysis – (Hypothetical Example)

#### Predominantly I Class Shares

Fund Name	Fund Balance	Plan Participants	Expense Ratio	Fund Expense	12b-1 Fee	Shareholder Servicing	Sub-TA Fee Credits	Total Revenue Credit
Large Cap Growth Fund	\$1,000,000	175	0.0098	\$ 9,800		0.001		\$1,000
S&P 500 Fund	\$2,000,000	275	0.0028	\$ 5,600		0.001		\$2,000
Large Cap Value Fund	\$1,750,000	200	0.0086	\$15,050		0.001		\$1,750
Mid Cap Growth Fund	\$ 250,000	125	0.0120	\$ 3,000		0.001		\$ 250
Mid Cap Core Fund	\$ 350,000	200	0.0100	\$ 3,500		0.001		\$ 350
Mid Cap Value Fund	\$ 400,000	100	0.0098	\$ 3,920		0.001		\$ 400
Small Cap ABC Fund	\$ 700,000	150	0.0106	\$ 7,420		0.001		\$ 700
International Large Cap Fund	\$ 650,000	125	0.0110	\$ 7,150		0.001		\$ 650
Intermediate Bond Fund	\$ 530,000	250	0.0062	\$ 3,286		0.001		\$ 530
Stable Value Fund	\$1,700,000	120	0.0050	\$ 8,500		0.001		\$1,700
Target Date 2020	\$ 70,000	15	0.0076	\$ 532		0.001		\$ 70
Target Date 2030	\$ 150,000	25	0.0080	\$ 1,200		0.001		\$ 150
Target Date 2040	\$ 300,000	25	0.0083	\$ 2,490		0.001		\$ 300
Target Date 2050	\$ 150,000	5	0.0083	\$ 1,245		0.001		\$ 150
	\$10,000,000			\$72,693	0	\$10,000	0	\$10,000

Total Annual Recordkeeping and Reporting Fee	\$12,500
Annual Investment Advisor Fee (flat dollar)	\$25,000
Annual Investment Advisor Fee (asset-based fee)	\$ -
Total Annual Recordkeeping, Reporting and Investment Advisor Fees	\$37,500
Less: Total Revenue Credit Offset	\$(10,000)
<b>Annual Net Plan Credit (or Annual Additional Fee Due)</b>	<b>\$(27,500)</b>

- I shares result in lower fund expenses for participants
- Only shareholder servicing fees; no 12b-1 or sub T/A fees
- Total Revenue Credit is \$10,000

**The Total Revenue Credit of \$10,000 does not cover recordkeeping/administrative and investment consulting costs. The shortfall of \$27,500 must be paid by plan sponsor in hard dollars or assessed to plan participants.**

**Note: I Share Class may not be available for all investment styles.**

\*Advisor fee data from Fee Benchmarkr,™ an independent advisor fee and service database and benchmarking tool built and maintained by Ann Schleck & Co LLC. Visit [www.annschleck.com](http://www.annschleck.com) to learn more.

## How Plan Objectives Impact Participants

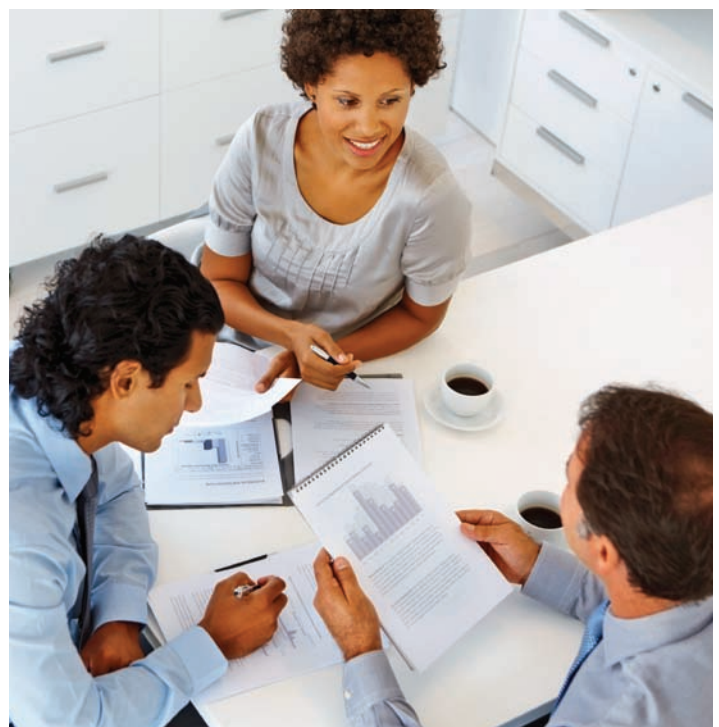
In the first scenario, plan revenue from the A share class mutual funds produced a total credit that paid all plan costs (no out-of-pockets for plan sponsor or participants). In the second scenario, use of I share class funds resulted in lower investment expenses, but a smaller total revenue credit did not offset all recordkeeping, administration and investment consulting costs. As a result, either the plan sponsor or participants – or a combination of the two - would have to pay these expenses through explicit charges. The “right” choice depends on the objectives.

Objective	Plan Sponsor Preference	Participants Pay through Mutual Fund Revenue Sharing	Plan Sponsor Pays
Plan revenue pays for all expenses, with no out-of-pockets for the plan sponsor or participants	Scenario 1 – predominantly A share class funds with revenue sharing	\$42,170	0
Provide lowest investment cost option with sponsor paying hard-dollar expenses not absorbed by plan revenue	Scenario 2 – predominantly I share class funds with low investment costs	\$10,000	\$27,500

A wide range of fee arrangements and compensation agreements are available to plan sponsors. As shown in the two examples, the correct choice depends on your objectives and priorities. In the first scenario, participants absorbed all plan fees through the funds’ expense ratios. In the second scenario, the lower fund expense ratios did not cover all plan fees. Participants paid less for investments than in the first scenario, and the plan sponsor and/or participants paid \$27,500 to cover the shortfall not absorbed through revenue sharing.

### Be Sure To Ask...

**If your plan uses a recordkeeper and mutual fund owned by the same company, ask how much of the fund’s revenue is being shared with the recordkeeper. It’s your right as a client – and duty as a fiduciary – to know who and how much is being paid.**



## Key Takeaways and Action Items

- Use this example as a framework to better understand the varying revenue and expense components in a typical plan. These are the types of details you should be seeing.
- A bewildering variety of fee arrangements and agreements exist out there. Without a clear picture of how parties are being paid for services performed, it's virtually impossible to assess fees and reasonableness.
- Plan sponsors must insist on full transparency of fee arrangements and have a working knowledge of the underlying details.



## Simple Changes Can Save A Lot

Investment managers often provide the same product in a variety of vehicles with different fee structures, and plan sponsors may be able to change from an R or A share class to an institutional share class or CTF and keep the same portfolio managers. A plan could save 20-25 basis points in costs without going through the hassles associated with switching recordkeepers.



# 4

## Benchmarking: Determining Whether Fees Are “Reasonable”

Getting your arms around the vast array of plan costs and services is tough enough. But how do you know whether the fees you’re paying are “reasonable?”

Comparing your plan’s costs to those of similar defined contribution plans can provide a big part of the answer. A benchmarking analysis looks at comparative data to identify opportunities for improvement.

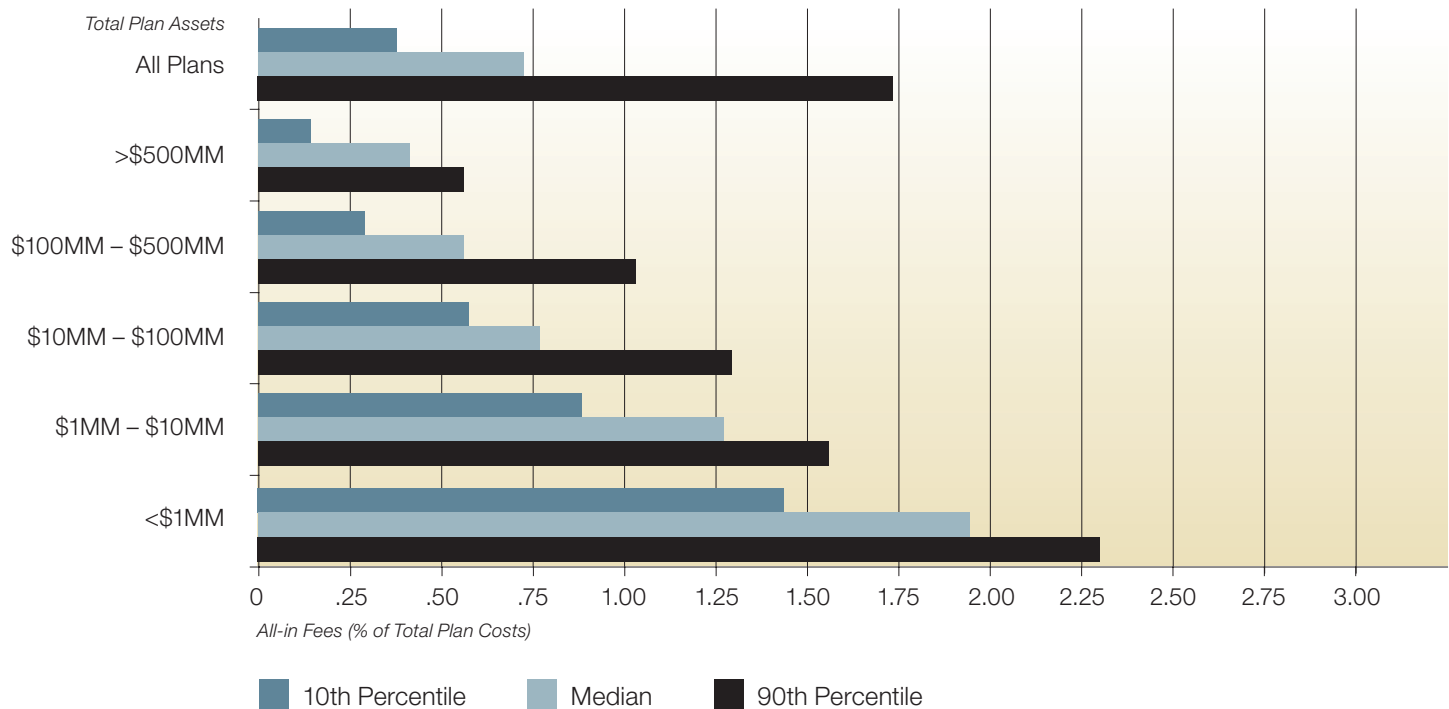
Performing a benchmarking analysis isn’t easy, and plan sponsors are encouraged to rely on third-party consultants for support. Using an outside resource to conduct these analyses can leverage industry expertise and experience that you may not have within the organization. And even if you aren’t already using a consultant for other parts of your plan, engaging one to assist with benchmarking can make a lot of sense.

### Put Your Plan’s Cost Structure in Context – Make Sure Your Peers Are Really Peers

You can do everything else right in your benchmarking study, but if the plans you’ve chosen for comparison aren’t similar, you’re wasting your time. Worse yet, you could come up with conclusions suggesting actions that don’t benefit participants.

Of all the plan characteristics that influence cost, size is the key driver and is critical in defining peer groups.

#### DC Plans Differ Significantly in Total Plan Costs



Source: Deloitte “Defined Contribution/401(k) Fee Study, Spring 2009”

While larger plans generally have significantly lower costs than smaller ones (as a percentage of assets), there also can be a wide cost variance for plans of similar size. Consider two plans with the same level of assets and number of participants:

### Sample Plan Costs

	Plan A	Plan B
Plan Assets	\$50MM	\$50MM
Plan Cost (% of Assets)	0.65%	0.90%
Total Plan Cost per Year	\$325,000	\$450,000
No. of Participants	1,000	1,000
Avg. Cost per Participant	\$325	\$450

### Why Large Plans Pay Less

**The main reason large plans (in terms of asset size) have access to lower-cost fee structures is economies of scale. That is, more assets give plan sponsors access to investment vehicles like institutional share classes that can spread investing costs over a larger base. As a result, individual participants pay less.**

Is Plan B paying too much? Though similar in size, should these plans be in the same peer group? Consider some additional details:

	Plan A	Plan B	Implications
Participant Investment Allocations	20% Equity 60% Fixed Income 20% Stable Value	60% Equity 25% Fixed Income 15% Stable Value	Investment costs tend to be significantly higher for equities than fixed income and stable value vehicles. Plan A investment costs are significantly less than Plan B because of participant allocations to lower-cost products.
Employee and Employer Contribution Rate	10%	5%	Plans with higher contribution rates typically have lower costs since plan sponsors can anticipate higher asset levels and access better pricing.
Automatic Enrollment	Yes	No	Automatic enrollment may result in lower costs by increasing plan assets and thus qualifying for lower-cost investment vehicles.
Number of Locations	1	25	More locations and geographic dispersion often increase costs.

Differences in plan characteristics help explain why similar size plans can have cost structures that vary significantly. Many variables can impact plan costs, including industry type, geography, number of locations, employee and employer contribution rates, enrollment practices, and range and quality of services.

The important thing is to do your homework and construct the most relevant set of peers for your plan.

**In addition to benchmarking costs and services, make sure you assess your fee disclosure practices against current industry standards. Groups like the Committee on Investment of Employee Benefit Assets (CIEBA) provide guidance and insights on effective DC plan fee disclosure.**

### **Establish a Baseline: Identify Costs for all Plan Services**

Consider fees at the aggregate and component levels. Gather data on all plan costs and services using fee schedules, invoices, reports, recordkeeping and service contracts, and prospectuses. If you can't find all the information you need, contact your consultant/advisor or specific service provider for assistance.

Be thorough, and try to identify costs in detail, breaking them down into major categories like investment management, consulting, recordkeeping, and administration. Include time spent by your internal staff when calculating all-in plan administration expenses.

With the proliferation of bundled plan arrangements and revenue-sharing agreements, it has become increasingly difficult to identify precisely how much is being paid for specific services. Consider the scenario of two investment products with the same objective: one is a mutual fund that shares revenue, the other a CTF that does not.

### **Cost Impact of Revenue Sharing**

<b>Investment Vehicle</b>	<b>Cost (% of Assets)</b>	<b>Revenue Sharing</b>	<b>Net Investment Fees</b>
Large Cap Equity Mutual Fund	0.80%	0.30%	0.50%
Large Cap Equity CTF	0.55%	0	0.55%

On the surface, it appears the participant pays more for the mutual fund than its CTF equivalent. However, because the mutual fund shares revenue and offsets some of the recordkeeping expenses, the net investment fee is actually lower for the mutual fund (0.50% versus 0.55%).

The good news is that DC service providers are being asked to be much more transparent about revenue-sharing agreements, and most plan sponsors report they have no trouble getting the detail needed.

Having a good way to assemble and catalog the data is crucial. Worksheets that can help are available from the U.S. Department of Labor ([www.dol.gov](http://www.dol.gov)) or the 401k Averages Book ([www.401ksource.com](http://www.401ksource.com)).

## Compare Costs

Once the data is collected, compare costs to other plans. As mentioned earlier, it's important that benchmark groups resemble your plan as closely as possible.

First, compare total plan costs to benchmarks, and then compare individual parts – investment management fees, recordkeeping, trust/custody and other fees. Vendors can help you establish suitable benchmarks. You can also purchase helpful benchmarking tools such as the 401k Averages Book.

The following is an example of a cost analysis framework for investment products.

### Fund Benchmarking – Investment Expenses – (Hypothetical Example)

		Competitive Ranking by Investment Style – Expenses				
Product	Operating Expense Ratio	1st Quartile Avg. Expense Ratio	2nd Quartile Avg. Expense Ratio	3rd Quartile Avg. Expense Ratio	4th Quartile Avg. Expense Ratio	Fund Expense Quartile Ranking
Fund A	1.10%	0.60%	0.78%	0.98%	1.15%	4
Fund B	0.89%	0.75%	0.91%	1.11%	1.35%	2
Fund C	0.79%	0.65%	0.81%	1.04%	1.26%	2

Focus on investment products with 3rd or 4th quartile peer group expense ratios – these rank above the norm for expenses in their peer groups.

The above illustration is intended to show a hypothetical example of mutual fund expense ratios and where they may rank relative to peer groups. This hypothetical illustration is not intended to represent a specific type of mutual fund, nor does it represent actual mutual fund peer ranking. This table is for illustrative purposes only.

## Compare Quality of Services

Next, benchmark service quality at both the plan and participant levels:

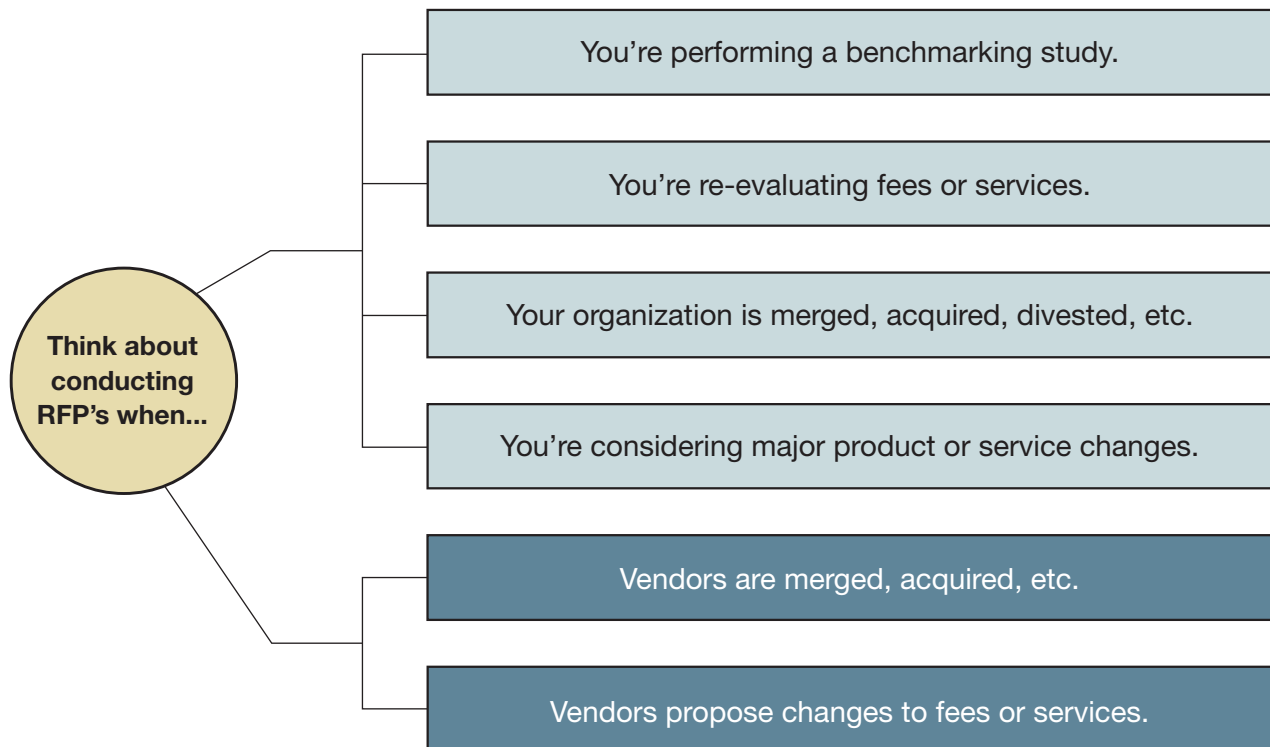
- **Plan services** are those used by the sponsor to manage the plan's operation. They include investment management services, management reports, plan documentation, government reporting and investment reviews.
- **Participant services** include statements, 800 numbers, internet access, benefit responsiveness, and communication and educational meeting materials.

Comparing costs and services against benchmarks is easier than comparing value. The latter requires a significant amount of detail. For example, to assess the quality of operations services, you need a detailed description of features as well as measures of accuracy and processing time. You may find that reliable information can be solicited from service providers by issuing Requests for Proposals (RFPs) or Requests for Information (RFIs).

## The Bottom Line

A benchmark study is not something you do once and then put on a shelf. Most plan sponsors perform periodic reviews, at least once every three years.

There's no hard-and-fast rule for judging whether your plan is paying too much. What's important is knowing how much you pay for services and how that compares with other plans. Working with a consultant to benchmark plan services and costs goes a long way toward ensuring you fulfill your fiduciary obligations and responsibilities to plan participants.



## Key Takeaways and Action Items

- **Conduct periodic benchmarking studies faithfully.**
- **Consider using consultants and financial advisors...going it alone can be tough.**
- **Other helpful resources:**
  - Pension Data Sources ([www.401ksource.com](http://www.401ksource.com))
  - 401k Averages Book (updated annually), 401k Averages Book Fee Worksheet, 401k Book Service Summary Worksheet
  - Ann Schleck & Co. ([www.annschleck.com](http://www.annschleck.com))
    - Monarch Online Fee Benchmarker™ – an online tool that compares advisor/consultant fees (both commission and fee-for-service) to a database of industry norms for a selected plan size.
    - Monarch Advisor Fee Almanac – provides fee benchmarking information on advisor fee trends, methods and pricing norms, along with over 20 fee and service illustrations for defined contribution plans ranging in size from start-ups to \$500 million in assets.
  - Free comparison tool from BrightScope ([www.brightscope.com](http://www.brightscope.com))
  - Benchmarking services and free tools ([www.fiduciarybenchmarks.com](http://www.fiduciarybenchmarks.com))
  - Department of Labor ([www.dol.gov](http://www.dol.gov))
  - 401(k) Plan Fee Disclosure Form

The inclusion of websites and other resources in this guide does not constitute an endorsement of any products or services by Victory Capital Management or KeyCorp.



# 5

## What You Can Do to Manage Costs

**You've determined that there are opportunities to reduce costs for your defined contribution plan and its participants while securing the same or similar services compared to other plans. Now what?**

**While specific actions will depend upon your plan's unique circumstances and benchmark study results, some strategies are universal.**

### **1. Focus on Investment Management Fees – That's Where the Money Is**

Since investment costs generally account for well over 90% of plan expenses, this is where changes can have the greatest impact.

- Look for lower-cost share classes. Mutual funds are often available in less expensive institutional-type share classes. The size of your plan determines whether you can access institutional shares. The greater your plan's assets, the more leverage you have.
- Determine whether collective trust funds and/or separately managed accounts are appropriate for your plan. CTFs and SMAs offer investment strategies comparable to those of mutual fund managers, usually at lower cost. Your plan may be large enough for these to make sense.

### **2. Work with an Investment Consultant or Financial Advisor**

Consultants can help you uncover opportunities to strengthen fee and service structures as part of a benchmarking study. They can also be instrumental in implementing changes, including renegotiating arrangements with investment managers, vendors and service providers.

### **3. Renegotiate Fees and Service Standards**

If you've determined that costs and services are missing the mark, meet with the appropriate service provider and share your findings. If the provider can meet your requirements, get it in writing with a revised contract and an agreed-upon schedule for making changes.

If your service provider cannot address your concerns, look for a replacement. Test the waters by sending out a blind request for information or a request for proposals to see how competitive your vendors are for the services they offer.

As part of this exercise, also consider whether bundled or unbundled fee arrangements work better for your plan. There is no one-size-fits-all answer – the right solutions will be driven by your specific circumstances.

### **4. Adopt a Fee Policy Statement – Always a Best Practice**

A fee policy statement provides a basis for disciplined expense management. Creating a policy gives you a set of guiding principles, along with a framework for decision-making and documenting processes. At a minimum, include in your Investment Policy Statement (IPS) the criteria and process that will be followed to monitor and evaluate plans fees.

## Fee Policy Statement Checklist – What to Include

### Service Provider Standards

- ✓ Cost management objectives for the plan that reflect a commitment to keeping costs reasonable for the services provided.
- ✓ Itemization of services to be provided and standards for each provider, including expectations for costs and performance.
- ✓ Formal service agreements with each provider to strengthen ability to meet regulatory requirements.
- ✓ Process and schedule for reviewing service offerings and expenses, including benchmarking studies.
- ✓ Standard disclosure and transparency requirements for service providers to ensure regulatory compliance.

### Investment Management

- ✓ Investment policy statement (see separate discussion).
- ✓ Periodic reviews and updates of investment policy statement.
- ✓ Periodic reviews of investment selections, costs and alternatives.

### Performance Review and Benchmarking

- ✓ Schedule for total plan cost audit and projections (e.g., annually).
- ✓ Schedule for review of service provider costs and performance against agreed-upon standards.
- ✓ Schedule for benchmarking analysis (e.g., once every two years).

### Participant Communications

- ✓ Communications strategy and policy with focus on:
  - Making information clear and comprehensible
  - Reporting to participants in ways that are meaningful and timely
- ✓ Audit of current fee disclosures to participants.
- ✓ Comparison of plan fee disclosure practices with those of other plans.
- ✓ Confirmation of compliance with regulatory requirements.

### Legal and Regulatory Developments

- ✓ Ongoing process for monitoring legal and regulatory developments for costs management and fee disclosure.
- ✓ Identification of anticipated changes and development of a strategy to address them.

## Investment Policy Statement – Remember to Include Fees

An investment policy statement (IPS) typically describes a wide range of plan features: investment objectives, benchmarking protocol, classes and styles of investments to be included in the plan, and reporting requirements for investment managers. In addition, the IPS should address fee-related items such as:

- Fee benchmarks for investment options.
- Disclosure of revenue sharing and potential conflicts of interest.
- Turnover and trading costs for each investment vehicle.
- Expectations for fee levels in searches for and hiring of investment managers.



# 6

## New Regulations Mean More Communications

**The regulatory environment is already challenging, and it promises to get even tougher. With defined contribution plans solidly entrenched as the nation's primary form of retirement savings, the Department of Labor (DOL) is implementing sweeping new regulations designed to ensure that participants receive information concerning fees they, or the plan, pay. The DOL's position is that only if the fee arrangements are transparent will the true costs, and the reasonableness of those costs, be able to be assessed. These changes will have a profound impact on communications between all the key players in retirement plans – sponsors, service providers and participants.**

### It Started With Three Regulatory Initiatives

Policymakers have been concerned with DC fee issues for some time, driven by concerns that:

- Some fees paid to service providers by third parties or sub-contractors may influence their recommendations to plan sponsors.
- Fees to some service providers may be unreasonable when all fees are evaluated either as a whole, or when broken down by fees paid per service.
- Participants may not be receiving adequate information on the amount of the fee.

In recent years, the DOL launched three initiatives aimed at increasing the transparency of fees paid for retirement plan services, including more disclosure about fee arrangements to participants. These initiatives focused on:

1. Disclosing additional information about fees paid to service providers on Form 5500 (see sample page in appendix).
2. Increased fee disclosure by providers to sponsors.
3. Increased fee disclosure by sponsors and service providers to participants.

### First Up: A Revised Form 5500

The first of these initiatives was completed in 2007 with the release of final revisions to Form 5500. Effective for plan years beginning on or after January 1, 2009, the new form requires:

- Increased disclosure of direct and indirect compensation. Large-plan filers (100 or more participants) also must report the identity of each person who received direct or indirect compensation of \$5,000 or more.
- Identification of service providers that do not provide the necessary information to plan sponsors.

The DOL clearly believes plan fiduciaries should be reviewing fees on an annual basis. The changes to Form 5500 are aimed at increasing transparency of plan-related fees and supplying service provider agreements to plan sponsors on a routine basis.

### Next Up: New Disclosure Rules on Fees and Potential Conflicts of Interest

The second initiative focuses on getting more information to retirement plan sponsors to help them make prudent decisions about services, costs and service providers. In July 2010, the DOL released new regulations designed to assist fiduciaries in determining:

- Whether compensation paid to plan service providers is reasonable.
- Whether any potential conflicts of interest exist that may affect a service provider's performance.

Effective on January 1, 2012, the regulation, which falls under ERISA Section 408(b)(2), applies to both new and existing service arrangements.

## Which Plans and Providers Are Covered by the New 408(b)(2) Rules?

Under the new 408(b)(2) rules, covered service providers are required to disclose information about their direct and indirect compensation for services provided to covered plans. So what determines whether a provider or plan is covered?

	Definition
Covered Plans	<ul style="list-style-type: none"> <li>• Any defined contribution or defined benefit pension plans</li> <li>• Does <b>not</b> apply to welfare benefit plans, simplified employee pensions (SEPs), simplified retirement accounts (SIMPLEs) or IRAs</li> </ul>
Covered Providers	<ul style="list-style-type: none"> <li>• Any party that has entered into an arrangement with a covered plan and reasonably expects to receive \$1,000 or more in total compensation – either direct or indirect – in connection with their services.</li> <li>• Any party that provides any of the following to a covered plan: <ul style="list-style-type: none"> <li>– Fiduciary services</li> <li>– Registered investment advisory services</li> <li>– Recordkeeping or brokerage services in connection with participants’ investment options under the plan</li> <li>– Other services for which indirect compensation is received, including accounting, investment advisory/consulting, legal and recordkeeping</li> </ul> </li> </ul>

The bottom line for plan sponsors? Expect that all essential service providers, including recordkeepers, investment managers and third-party administrators, are “covered” providers. Make sure you’re getting the information required from each one of them.

## Exactly What Must Service Providers Disclose?

Covered service providers are required to supply detailed information to the plan fiduciary in writing and in advance of executing the service arrangement:

Services	A description of services to be provided.
Status	Whether the service provider expects to provide fiduciary services and/or services as a Registered Investment Advisor.
Compensation	<p>A description of:</p> <ul style="list-style-type: none"> <li>• <b>Direct compensation</b> that the service provider, an affiliate or a subcontractor reasonably expects to receive in connection with the services.</li> <li>• <b>Indirect compensation</b> that the service provider, an affiliate or a subcontractor reasonably expects to receive.</li> <li>• <b>Compensation paid among related parties</b> and whether it is charged on a transaction basis (such as commissions) or directly against the covered plan’s investments (such as 12b-1 fees).</li> <li>• <b>Compensation in connection with service termination.</b></li> </ul>

Certain service providers have additional reporting requirements. For example, recordkeepers, brokers and investment fiduciaries must provide information on fees and expenses for the plan’s investment alternatives. They must also disclose fees for recordkeeping services, which in some cases may be a reasonable good faith estimate of the cost.



## Plan Sponsors Have Compliance Responsibilities Too

Clearly service providers will spend considerable time and money complying with the new disclosure requirements. But plan sponsors also have new responsibilities – namely reviewing provider disclosures and verifying that they are in compliance.

### Compliance Responsibilities for Plan Sponsors

Section 408(b)(2) allows plan sponsors to engage service providers and compensate them as long as:

- The services are provided as part of a contract or arrangement that is reasonable.
- The services are necessary for the establishment or operation of the plan.
- No more than reasonable compensation is paid for these services.
- The sponsor ensures all required written disclosures are received.

While this basic regulation has been around for years, the written disclosures are now part of determining whether an arrangement is reasonable. *Even if the contract itself is reasonable, compliance with Section 408(b)(2) is not fulfilled unless the required disclosures are provided.*

## What's a Sponsor to Do?

Plan sponsors can take a number of steps to help deal effectively with the new regulations.

### In Terms of Existing Service Provider Agreements

- Make sure you have identified all covered service providers currently being used and review all disclosures being provided.
- If you do not have the required disclosure from any service provider, contact them and define your expectations for additional disclosure.
- Develop standardized methods for collecting disclosure and documentation to ensure consistency and usability of information.
- Assess the services described in the disclosures and ensure that these are consistent with the plan's needs and expectations.
- Review any compensation and services disclosed by a provider for clarity and reasonableness, using benchmark studies as appropriate. Consider retaining an investment consultant who has access to relevant market information about fees and price points.

- Ensure that you are in agreement with each provider as to fiduciary status on a service-by-service basis.
- Establish policies and procedures that define compliance methods.
- Document all reviews of services and compensation and your findings.

### In Terms of New Agreements and RFPs

- Review disclosures before engaging any new service providers and upon any contract extension or renewal.
- Revise any request for proposal methodologies to ensure that your disclosure expectations are clearly defined.
- Prior to any contract renewal or engagement of a new provider, review their disclosure against your expectations.

Even though the new rule does not require a written contract or arrangement, having one is clearly a good idea. It also makes sense to attach the necessary disclosures to the contract, making it easy to track and keep current with any updates to the service provider agreement.

***And remember, disclosure alone is not the complete story. Plan sponsors must still determine if the service arrangement is reasonable.***

## The Third Reg: Communicating Fees and Expenses to Participants

In October 2010, the DOL acted on the final fee initiative with the announcement of rules that give DC plan participants more information regarding fees and expenses.

Issued under ERISA section 404(a)(1), the new rules apply to all 401(k) plans and other participant-directed individual account plans subject to ERISA, except for IRAs, SEPs and SIMPLEs. Plan fiduciaries must now:

- Provide participants with quarterly statements of plan fees and expenses deducted from their accounts.
- Give participants core information about investments available under their plan, including the cost of these investments.
- Use standard methodologies when calculating and disclosing expense and return information.
- Present the information in an easy-to-understand format to help participants compare plan investment options.
- Give participants access to supplemental investment information in addition to the basic information required.
- Annually, both Plan related fee information and Investment related fees (in the form of a comparative chart) must be disclosed.

The requirements apply to plan years beginning on or after November 1, 2011, and are effective on January 1, 2012, for plans on a calendar-year basis.

## Failing to Comply Would Not Be Prudent

**Compliance with the new participant disclosure rules under section 404(a)(1) is a mandatory, core fiduciary obligation. Plan fiduciaries that do not comply may be subject to claims of breaching their ERISA fiduciary duties of prudence and loyalty.**

### Communications with Participants: The Details

The new regulation requires a plan sponsor to provide participants with information in two main categories: plan-related information and investment-related information.

#### Plan-Related Information

To meet the plan-related disclosure requirement, three types of information must be provided to each participant:

Type	Includes	Examples
General Plan	Information about the structure and mechanics of the plan.	<ul style="list-style-type: none"> <li>• An explanation of how to give investment instructions under the plan</li> <li>• A current list of the plan's investment options</li> </ul>
Administrative Expenses	Explanation of any fees and expenses for general plan administrative services that may be charged to or deducted from all individual accounts.	<ul style="list-style-type: none"> <li>• Legal fees</li> <li>• Accounting expenses</li> <li>• Recordkeeping services</li> </ul>
Individual Expenses	Explanation of any fees and expenses that may be charged to or deducted from the individual participant account based on actions taken by that person.	<ul style="list-style-type: none"> <li>• Fees and expenses for plan loans</li> <li>• Charges for processing qualified domestic relations orders</li> </ul>

Information on investment instructions, limitations on instructions and descriptions of investment options and other restrictions (including fees and penalties involving trading) must be conveyed automatically on or before the date on which the participant can first give investment directions and at least annually thereafter.

Participants must receive quarterly statements (at a minimum) showing the dollar amount of plan-related fees and expenses charged to their accounts and a description of the services provided in exchange for those charges or deductions.

Annual disclosures are also required of both Plan related fee information and Investment related fees (in the form of a comparative chart).

In addition, a description of any plan changes (defined as those related to: changes in timing and type of investment instruction; limitations or restrictions on investments; voting, tender and other corporate actions; and new investment funds, managers, or brokerage windows) must be furnished to participants at least 30 days, but not more than 90 days, before the effective date of the change. When changes must be made in a way that the 30-day-notice requirement cannot be met, the regulation requires that information be provided as soon as practicable.

## Investment-Related Information

The investment-related information required must address several areas for each investment option in the plan.

Type	Includes
Performance	<ul style="list-style-type: none"><li>• Historical performance information for 1-, 5- and 10-year trailing periods, or for the life of the investment if shorter</li></ul>
Benchmark	<ul style="list-style-type: none"><li>• The name and performance of an appropriate broad-based index over a comparable period</li></ul>
Fees and Expenses	<ul style="list-style-type: none"><li>• The total annual operating expenses expressed as both a percentage of assets and as a dollar amount for each \$1,000 invested</li><li>• Any shareholder-type fees or restrictions on the participant's ability to purchase or withdraw from the investment</li></ul>
Internet Web Site Address	<ul style="list-style-type: none"><li>• Internet web site address that provides access to additional information about the investment</li></ul>
Glossary	<ul style="list-style-type: none"><li>• General glossary of terms to assist participants in understanding the plan's investment options, or an Internet web site address that provides access to a glossary</li></ul>

The regulations include specific exemptions and special rules regarding disclosures for employer stock funds, annuity options, bank investment vehicles and fixed return investments in a plan.

### DOL's Model Chart for Investment Info

The DOL also requires plan sponsors to furnish participants with information in a clear and understandable chart or similar format to help them compare investment options available under the plan.

The DOL offers a model comparative chart, so sponsors don't need to reinvent the wheel. Excerpted sections of the model chart are included in the appendix of this guide. You can find the complete model at [www.dol.gov/ebsa/participantfeerulemodelchart.doc](http://www.dol.gov/ebsa/participantfeerulemodelchart.doc). Sponsors may add information beyond what the model requires as long as that information is accurate and not misleading.



## Communications Challenges for Plan Sponsors

While the new rules should enhance participants' understanding of the fees they pay, plan sponsors face some significant challenges in complying with them.

- While more transparency can be beneficial to participants, it also can create information overload, especially at first. Plan sponsors must mind the type and volume of information disseminated to ensure it is meaningful. For example, the requirement that plan administrators provide advance notice of **all** investment related changes – not just material ones – may cause participants to overlook critical information when presented.
- Demands on information from service providers will increase significantly, and plan sponsors will need to actively involve them in the process, giving them clear and precise guidance on what's needed.
- The new regulations will lead to heightened focus by participants on fees, which could increase plan sponsor interest in open-architecture platforms over proprietary models.
- Although service providers are required to generate much of the core data, plan sponsors must be prepared to coordinate the collection of information from multiple sources, assemble it in user-friendly and understandable ways, add any other required disclosures...then effectively communicate everything to participants.

Sponsors do catch a break in one regard: If a plan sponsor reasonably, and in good faith, relies upon information provided by a service provider, the new rules offer protection from liability for the completeness and accuracy of information provided to participants.





## You may be a fiduciary if you...

In late October 2010, the DOL released a proposed regulation that would significantly broaden the definition of a fiduciary under ERISA.

Under the proposed regulation, you may be a fiduciary if you...

- provide advice, appraisals or fairness opinions as to the value of investments; offer recommendations as to buying, selling or holding assets; or make recommendations regarding management of securities or property.
- acknowledge fiduciary status for purposes of providing advice.
- operate as an investment advisor under the Investment Advisors Act of 1940.
- provide advice or make recommendations pursuant to an agreement, arrangement or understanding.

Meeting any **one** of these criteria will result in fiduciary status under ERISA.

If implemented, the DOL – and a plaintiff’s attorneys – would find it far easier to establish the fiduciary status of investment service providers in enforcement and litigation matters.

## Congress and the Push for More Fee Disclosure

In recent years, Congress has been pushing for the same changes as the DOL: increased disclosure of fees and fee arrangements and expanded participant communications. In the 111th Congress, there were three bills in the House and Senate dealing with DC plan fees and transparency.

The DOL worked closely with members of Congress to address these issues, and much of what was sought by the proposed legislation was incorporated in the new regulations announced in 2010. While the bills that had been introduced appear to be dead for now, expect the topic to resurface quickly if legislators sense problems that are not being solved by the regulations

## Key Takeaways and Action Items

- **Thoroughly review all of your contracts and arrangements with service providers to ensure you have the right types of information, descriptions and details needed to meet the new requirements.**
- **Reach out to service providers and make sure you are on the same page in terms of expectations and deadlines.**
- **Stay on top of further regulatory developments and legislation.**
- **Establish policies and procedures for compliance and disclosure processes.**



# 7

## Wrapping it Up

There's no easy way around it, the defined contribution plan fee landscape is complex and continually changing. Navigating through it is a challenge even for trained financial professionals, let alone plan sponsors whose expertise may lay elsewhere.

- Plans involve numerous providers who perform a variety of complex, interconnected functions.
- Fee arrangements can be difficult to understand, and revenue sharing can make it hard to sort out who's paid to do what.
- ERISA is intimidating, and new regulations are being introduced at a rapid pace.
- Participants deserve to be informed about fees in simple terms, but fee complexity can mystify the communications process.

Nonetheless, plan sponsors must protect themselves and their participants from unreasonable expenses. And sometimes the changes that can have the greatest impact are relatively straightforward. For example, changing share classes or investment vehicles can mean significant savings with minimal effort, while switching to a less expensive source for recordkeeping, which represents a small percentage of plan costs, can be disruptive and yield marginal savings.

Schooling yourself on plan fees and best practices is a good start. Going it alone, however, may be asking a bit too much. Use your knowledge to recruit and make the most of relationships with financial advisors, consultants, and service providers. Then you'll have the best of all worlds.

## Glossary of Retirement Plan Terms

**401(k) Plans:** Employer-sponsored defined contribution plans in the private sector.

**403(b) Plans:** Defined contribution plans established for employees of certain tax-exempt organizations and public schools, and for self-employed ministers and their employees.

**404(a)(1)(a) and (b):** The section of Title I of ERISA that establishes the duties of a plan fiduciary, which are to act solely in the interest of participants and beneficiaries. This section includes the stipulation that the fiduciary must ensure plan expenses are reasonable for services provided. The final rule amended in 2010 provides that:

- The investment of plan assets is a fiduciary act governed by the fiduciary standards in ERISA section 404(a)(1)(a) and (b), which require plan fiduciaries to act prudently and solely in the interest of the plan's participants and beneficiaries.
- When a plan allocates investment responsibilities to participants or beneficiaries, the plan administrator must take steps to ensure that such participants and beneficiaries, on a regular and periodic basis, are made aware of their rights and responsibilities with respect to the investment of assets in their accounts and are provided sufficient information regarding the plan and the plan's investment options, including fee and expense information, to make informed decisions with regard to their individual accounts.

**404(c):** A section of Title I of ERISA that protects plan fiduciaries from liability for the results of decisions made by plan participants who direct the investments in their accounts. Plan fiduciaries are still responsible for making suitable investment options available to plan participants.

**408(b)(2):** A section of Title I of ERISA that provides plan sponsors certain protections as long as an arrangement or contract with a service provider is reasonable, the services provided are necessary and no more than reasonable compensation is paid for services. The DOL announced rule changes in 2010 that involve heightened disclosure and transparency under Section 408(b)(2) aimed at ensuring plan sponsors receive clear information about provider compensation and services. The new regulation:

- Applies to defined contribution plans and defined benefit pension plans and addresses the disclosure of the direct and indirect compensation certain service providers receive.
- Focuses on service providers and compensation arrangements that are most likely to raise questions for plan fiduciaries with respect to potential conflicts of interest that might compromise the quality of services.

**Actively Managed Funds and Accounts:** Investment strategies in which the manager actively constructs a portfolio of securities to generate a return that exceeds a benchmark.

**Annuity Investments:** Products offered by insurance companies that are widely used in retirement plans, with plan assets frequently packaged on a group annuity platform. The participant has a pooled investment account with a contract for insurance-related elements and charges, such as an annuity feature, interest and expense guarantees, and any death benefit provided during the contract term.

**Basis Point (BPS):** A unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security. The relationship between percentage changes and basis points can be summarized as follows: 1% change = 100 basis points, and 0.01% = 1 basis point.

**Benchmarking:** Analysis providing defined contribution plan peer group comparisons of cost and service levels; used by plan sponsors to help assess whether fees are reasonable for services received.

**Bundled and Unbundled Service Plans:** In **bundled** service arrangements, the sponsor hires one company to provide a full range of retirement plan services directly or through subcontractors. In **unbundled** arrangements, the sponsor uses a combination of service providers directly.

**Collective Trust Fund (CTF):** A tax-exempt, pooled investment vehicle administered by a bank or trust company that is available to defined benefit and defined contribution plans.

**Conflict of Interest:** Relationships with other parties or interests that impact a provider’s ability to act in the best interest of the plan and its participants.

**Custody/Trustee Expenses:** Charges for safekeeping of defined contribution plan assets.

**Defined Benefit Plan:** An employer-sponsored retirement plan where employee benefits are sorted out based on a formula using factors such as salary history and duration of employment. Investment risk and portfolio management are entirely under the control of the company. There are also restrictions on when and how you can withdraw these funds without penalties. Also known as “qualified benefit plan” or “non-qualified benefit plan”.

**Defined Contribution Plan:** A retirement plan in which a certain amount or percentage of money is set aside each year by a company for the benefit of the employee. There are restrictions as to when and how you can withdraw these funds without penalties.

**Department of Labor (DOL):** Federal department responsible for overseeing private pension plans. A unit of the DOL, the Employee Benefit Security Agency (EBSA) is responsible for ERISA enforcement.

**Direct and Indirect Compensation:**

**Direct:** Compensation paid directly by a plan sponsor to plan service providers. More easily identified and reported than indirect compensation, direct compensation includes:

- Fees paid by sponsors to providers using plan assets, including amounts deducted from participant accounts.
- Payments made by sponsors to providers that are reimbursed from plan assets.

**Indirect:** Compensation received by service providers from any source other than the plan sponsor, an affiliate or a subcontractor. Since providers use a wide variety of service models, fee structures and products, there are many different types of indirect compensation. More complex than direct compensation, indirect compensation can be difficult to identify and report.

**Distribution (12b-1) Fees:** Sales and marketing charges. In defined contribution plans, these fees are paid by funds to financial advisors for retirement plan services, including assistance in selecting and monitoring funds, communications, investor education, and related services.

**Due Diligence:** An investigation or audit of a potential investment. Due diligence serves to confirm all material facts in regards to a investment selection. Generally, due diligence refers to the care a reasonable person should take before entering into an agreement or a transaction with another party.

**Employee Retirement Income Security Act of 1974 (ERISA):** A federal law that sets minimum standards for most voluntarily established pension and health plans in the private sector to provide protection for plan participants. Title I of ERISA covers fiduciary standards applicable to employee benefit plans. ERISA is enforced by the U.S. Department of Labor.

**Fee Policy Statement:** A written policy that provides guidelines and objectives for plan expense management and a framework for decision-making and documenting cost control processes.

**Fee Types:**

Fee Type	Charges Based On	Examples
Asset-based	Amount of plan assets, typically expressed as percentages or basis points	Investment expense, annuity fee
Per-person	Number of participants in plan or number of eligible employees	Education and enrollment fees
Transaction-based	Execution of particular plan service or transaction	Loan origination fee, distribution expense
Flat rate	Fixed charge that does not vary	Annual audit fee

**Fiduciary:** According to the DOL, “using discretion in administering and managing a plan or controlling the plan’s assets makes that person a fiduciary to the extent of that discretion or control. Thus, fiduciary status can be based on the *functions performed for the plan*, not just a person’s title.” Plan fiduciaries typically include the trustee, investment advisors, individuals exercising discretion in the administration of the plan, plan administrative committee members, and those who select committee officials. The key to determining whether an individual or an entity is a fiduciary is whether they are exercising discretion or control over the plan.

**Finders’ Fees:** Payment to a financial advisor for directing a fund to a plan sponsor; paid out of mutual fund company resources rather than fund assets.

**Form 5500 Schedule C:** Annual report filed for employee benefit plans; revised in 2007 to include new reporting requirements for service provider fees and other compensation (on Schedule C of the 2009 Form 5500).

**Group Annuity Contracts:** See Annuity Investments.

**Insurance-Related Charges:** Fees for sales expenses, mortality risk charges, and the cost of issuing and administering the annuity contract.

**Investment Consulting Fees:** Expenses for consulting and plan advice on Investment Policy Statement drafting and investment manager due diligence, selection, monitoring, and fee negotiation.

**Investment Management Expenses:** Fees charged by the fund’s investment advisor for managing securities in the portfolio. Expenses vary depending upon investment strategy. These charges represent the vast majority of plan expenses, often exceeding 90% of total costs.

**Investment Policy Statement (IPS):** A written policy used as a guideline for investment decisions by plan fiduciaries. An IPS may include definitions of acceptable asset classes, due diligence approach, and fee guidelines for investment products.

**Mutual Fund Share Classes:** Mutual fund companies may provide a multi-class share structure to pay for the advisory and shareholder services offered to different types of investors in the same portfolio. For defined contribution plans, the most common are R, A, and I shares, each tailored to the requirements of different plan sizes. Because R- and A-share classes typically carry distribution (12b-1) and sub-transfer agency fees to fund the servicing needs of small- and mid-size plans, operating expenses tend to be higher than for the I-share-class funds used in large and mega plans.

**Non-Settlor Functions:** Plan expenses that may be paid from plan assets. Examples include costs for drafts of plan amendments for changes required by law, benefit calculations, nondiscrimination, and testing.

**Open Architecture:** This structure refers to trading and recordkeeping operations that make a wide range of investment vehicles available to a retirement plan.

**Passively Managed Funds and Accounts:** Investment strategies with the objective of matching the return of an index. Also known as index funds.

**Plan Participant Account Statement:** ERISA-required disclosure of account balances due to a plan participant.

**Plan Sponsor:** designated party, usually a company or employer, that sets up a healthcare or retirement plan such as a 401(k) for the benefit of the organization’s employees. The responsibilities of the plan sponsor include determining membership parameters, investment choices and, in some cases, providing contribution payments in the form of cash and/or stock.

**Proprietary Systems:** Platform structures making only one investment provider available to a plan sponsor.

**Recordkeeping Fees:** Fees associated with plan operations and administration, including transaction processing, reporting, transfers, valuations, inquiries, statement preparation, and distributions.

**Revenue Sharing:** Revenue sharing occurs when investment providers pay other plan service providers for product distribution or recordkeeping/administrative services, or “share” or rebate a portion of fees to these other providers.

**Safe Harbor:** A legal provision to reduce or eliminate liability as long as good faith is demonstrated. Under SEC rules, safe-harbor provisions protect management from liability for making financial projections and forecasts made in good faith.

**Separately Managed Accounts (SMAs):** Institutionally managed portfolios of securities for investments that are owned directly by the account holder.

**Service Providers:** Vendors providing custody/trustee, investment advisory, investment management, recordkeeping, brokerage, consulting, banking, third-party administration, fiduciary, accounting, actuarial, audit, legal, and valuation services to a plan.

**Settlor Functions:** Costs associated with the establishment of ERISA plans. Generally, settlor expenses must be paid by the plan sponsor and not from plan assets or revenue. Examples include costs for conducting a plan design study, amending the plan for non-legally required reasons, establishing a plan, and correction of compliance and fiduciary errors.

**Shareholder Servicing:** Fees typically paid to fund's transfer agent for recordkeeping, administration, and other account services.

**Stable Value Funds:** A portfolio of low-risk investments guaranteed against loss by insurance companies. Also known as Guaranteed Investment Contract (GIC) Funds.

**Sub-Transfer Agency Fees:** These fees represent a portion of transfer agency compensation paid out for defined contribution plan recordkeeping services provided by trust companies, third-party administrators, or banks.

**Summary Annual Report (SAR):** ERISA-required disclosure to plan participants on the financial condition of the retirement plan. The SAR is a summary of information included in the annual report (Form 5500) and must be provided to participants within nine months of the close of the plan year.

**Summary Plan Description (SPD):** ERISA-required document explaining how the retirement plan operates. The SPD must be provided to plan participants and beneficiaries and includes information on participant eligibility, employee rights, vesting, and claims and appeal provisions.

**Surrender and Transfer Charges:** Fees that may be assessed if the employer terminates an annuity contract early and assets are transferred to another investment option.

**Total Fund Operating Expense (Expense Ratio):** Expenses for investment management, distribution (12b-1) and other functions, including services and administration. Expenses vary depending upon share class and investment strategy.

**Total Revenue Credit:** Revenue sharing available to offset recordkeeping, administration, and investment consulting charges.

**Total Revenue Sharing Debit:** A shortfall that occurs when revenue sharing does not generate enough to pay for recordkeeping, administration, and investment consulting charges; must be paid by the plan, plan sponsor or a combination of the two.

**Trading Costs:** Transaction costs and brokerage fees for trades, trading costs are charged against fund value and are not included in the total operating expense ratio. Costs vary depending on portfolio turnover and market liquidity.

**Wrap Fees and Annuity Charges:** Insurance company costs for annuity feature, interest, and expense guarantees and any death benefit provided; these fees are for features not available in non-insurance vehicles and are in addition to investment product fees and sales commissions.



## Online Resources

### **401khelpcenter.com (www.401khelpcenter.com)**

Free information source for plan sponsors, retirement professionals, businesses and plan participants.

Topics include:

Changing plan vendors – [www.401khelpcenter.com/changing\\_vendors.html](http://www.401khelpcenter.com/changing_vendors.html)

Collective trust fund overview – [www.401khelpcenter.com/401k/ctf\\_overview.html](http://www.401khelpcenter.com/401k/ctf_overview.html)

Choosing and monitoring plan providers – [www.401khelpcenter.com/cw/cw\\_providers.html](http://www.401khelpcenter.com/cw/cw_providers.html)

Daily digest with news on 401(k) trends, opinions, rule changes, insights, surveys, studies and more – [www.401khelpcenter.com/401k/topics.html](http://www.401khelpcenter.com/401k/topics.html)

Fees and expenses – [www.401khelpcenter.com/cw/cw\\_planfees.html](http://www.401khelpcenter.com/cw/cw_planfees.html)

Selecting and monitoring pension consultants  
[www.401khelpcenter.com/401k/selecting\\_and\\_monitoring\\_pension\\_consultants.html](http://www.401khelpcenter.com/401k/selecting_and_monitoring_pension_consultants.html)

Studies and research – [www.401khelpcenter.com/cw/cw\\_studies.html](http://www.401khelpcenter.com/cw/cw_studies.html)

Understanding and uncovering hidden fees in qualified retirement plans –  
[www.401khelpcenter.com/pdf/mdh\\_understanding\\_fees\\_v4.pdf](http://www.401khelpcenter.com/pdf/mdh_understanding_fees_v4.pdf)

Understanding service delivery models – [www.401khelpcenter.com/401k\\_service\\_models.html](http://www.401khelpcenter.com/401k_service_models.html)

### **Ann Schleck & Co. www.annschleck.com**

Monarch Online Fee Benchmarker™ – an online tool that compares advisor/consultant fees (both commission and fee-for-service) to a database of industry norms for a selected plan size.

Monarch Advisor Fee Almanac – provides fee benchmarking information on advisor fee trends, methods and pricing norms, along with over 20 fee and service illustrations for defined contribution plans ranging in size from start-ups to \$500 million in assets.

### **BrightScope**

Free plan comparison tool – [www.brightscope.com](http://www.brightscope.com)

### **Deloitte**

Survey information on plan fees – [www.deloitte.com](http://www.deloitte.com)

### **Department of Labor (www.dol.gov)**

401(k) Plan Fee Disclosure Form Sample for use by plan sponsor in collecting and assimilating service provider costs – [www.dol.gov/ebsa/pdf/401kfefm.pdf](http://www.dol.gov/ebsa/pdf/401kfefm.pdf)

Form 5500 FAQs – guidance on requirements for reporting on plan years beginning on or after January 1, 2009 – [www.dol.gov/ebsa/faqs/faq\\_scheduleC.html](http://www.dol.gov/ebsa/faqs/faq_scheduleC.html)

Form 5500 – <http://www.dol.gov/ebsa/pdf/2010-5500-Schedule-C.pdf>

Meeting fiduciary responsibilities – [www.dol.gov/ebsa/publications/fiduciaryresponsibilities.html](http://www.dol.gov/ebsa/publications/fiduciaryresponsibilities.html)

Reporting and disclosure guide for employee benefit plans – [www.dol.gov/ebsa/pdf/rdguide.pdf](http://www.dol.gov/ebsa/pdf/rdguide.pdf)

Retirement plan compliance assistance – [www.dol.gov/ebsa/compliance\\_assistance.html](http://www.dol.gov/ebsa/compliance_assistance.html)

Selecting and monitoring pension consultants – [www.dol.gov/ebsa/newsroom/fs053105.html](http://www.dol.gov/ebsa/newsroom/fs053105.html)

Selecting and monitoring plan service providers – [www.dol.gov/ebsa/newsroom/fs052505.html](http://www.dol.gov/ebsa/newsroom/fs052505.html)

Understanding retirement plan fees and expenses – [www.dol.gov/ebsa/publications/undrstndgrtrmnt.html](http://www.dol.gov/ebsa/publications/undrstndgrtrmnt.html)

### **Drinker Biddle**

Legislative and regulatory updates – [www.drinkerbiddle.com](http://www.drinkerbiddle.com)

### **Fiduciary Benchmarks, Inc.**

Benchmarking services and free tools – [www.fiduciarybenchmarks.com](http://www.fiduciarybenchmarks.com)

## Online Resources – continued

### Groom Law Group

Defined contribution plan fee litigation updates – [www.groom.com](http://www.groom.com)

### Investment Company Institute (ICI)

Mutual fund and retirement plan cost information – [www.ici.org](http://www.ici.org)

### Pension Data Source, Inc.

401k Averages Book (updated annually), 401k Averages Book Fee Worksheet,  
401k Book Service Summary Worksheet – [www.401ksource.com](http://www.401ksource.com)

*The above list of resources is not a comprehensive list of websites, nor is the inclusion of these websites and other resources in this guide constitute an endorsement of any products or services by Victory Capital Management or KeyCorp.*

## Selecting and Monitoring Investment Consultants / Financial Advisors

Investment consultants and financial advisors can provide plan sponsors with valuable advice and service. However, not all consultants are alike, and plan sponsors must perform due diligence when hiring one. You need to be confident that a consultant has the skills, resources, and experience to do an effective job. You also must be certain that you're getting objective, unbiased counsel.

To help facilitate this process, the Department of Labor and the Securities and Exchange Commission have developed the following questions for plan fiduciaries to ask when evaluating plan advisors:

1. Are you registered with the SEC or a state securities regulator as an investment advisor? If so, have you provided me with all the disclosures required under those laws (including Part II of Form ADV)?
2. Do you or a related company have relationships with money managers that you recommend, consider for recommendation, or otherwise mention to the plan? If so, describe those relationships.
3. Do you or a related company receive any payments from money managers you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, what is the extent of these payments in relation to your other income (revenue)?
4. Do you have any policies or procedures to address conflicts of interest to prevent these payments or relationships from being a factor when you provide advice to your clients?
5. If you allow plans to pay your consulting fees using the plan's brokerage commissions, do you monitor the amount of commissions paid and alert plans when consulting fees have been paid in full? If not, how can a plan make sure it does not overpay for consulting fees?
6. If you allow plans to pay your consulting fees using the plan's brokerage commissions, what steps do you take to ensure that the plan receives best execution for its securities trades?
7. Do you have any arrangements with broker-dealers under which you or a related company will benefit if money managers place trades for their clients with such broker-dealers?
8. If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment advisor to the plan while providing the consulting services we are seeking?
9. Do you consider yourself a fiduciary under ERISA with respect to the recommendations you provide the plan?
10. What percentage of your plan clients utilizes money managers, investment funds, brokerage services, or other service providers from whom you receive fees?

Source: Department of Labor and Securities and Exchange Commission

## How Share Class and Investment Style Impact Mutual Fund Expense Ratios

Mutual fund companies usually offer a multi-class share structure to accommodate the advisory and shareholder servicing needs of different types of investors in the same portfolio of securities. For defined contribution plans, the most common are A, Retirement, and Institutional shares, each tailored to the requirements of different plan sizes.

Because A and R share classes typically carry distribution (12b-1) and sub-transfer agency fees to fund the servicing needs of small- and mid-size plans, operating expenses tend to be higher than for the Institutional share class funds used in large and mega plans.

The table below shows median expense ratios for a variety of investment styles and share classes. As you can see, the difference in expenses can be significant.

### Average and Median Gross Mutual Fund Expense Ratios

Morningstar Category (MS)	Fund Class (MS)	Average Total Expense% Prospectus (SI)	Median Total Expense% Prospectus (SI)
Large Value	A	1.23	1.21
	Inst	0.86	0.88
	Ret	1.24	1.33
Large Blend	A	1.30	1.25
	Inst	0.87	0.88
	Ret	1.25	1.29
Large Growth	A	1.33	1.26
	Inst	0.98	0.94
	Ret	1.32	1.40
Mid Value	A	1.35	1.31
	Inst	0.98	0.97
	Ret	1.40	1.43
Mid Blend	A	1.44	1.35
	Inst	1.00	1.04
	Ret	1.33	1.44
Mid Growth	A	1.62	1.40
	Inst	1.20	0.99
	Ret	1.45	1.50
Small Value	A	1.43	1.41
	Inst	1.06	1.09
	Ret	1.56	1.54
Small Blend	A	1.44	1.42
	Inst	1.03	1.06
	Ret	1.38	1.48
Small Growth	A	1.52	1.48
	Inst	1.17	1.13
	Ret	1.62	1.60

Morningstar Category (MS)	Fund Class (MS)	Average Total Expense% Prospectus (SI)	Median Total Expense% Prospectus (SI)
Target Date 2011-2015	A	1.10	1.04
	Inst	0.68	0.72
	Ret	1.16	1.21
Target Date 2016-2020	A	1.14	1.12
	Inst	0.76	0.78
	Ret	1.24	1.30
Target Date 2021-2025	A	1.12	1.07
	Inst	0.71	0.74
	Ret	1.19	1.24
Target Date 2026-2030	A	1.18	1.17
	Inst	0.80	0.80
	Ret	1.28	1.36
Target Date 2031-2035	A	1.14	1.15
	Inst	0.72	0.78
	Ret	1.22	1.27
Target Date 2036-2040	A	1.20	1.20
	Inst	0.83	0.83
	Ret	1.30	1.36
Target Date 2041-2045	A	1.16	1.16
	Inst	0.74	0.78
	Ret	1.24	1.26
Target Date 2050+	A	1.22	1.20
	Inst	0.83	0.85
	Ret	1.36	1.40

Morningstar Category (MS)	Fund Class (MS)	Average Total Expense% Prospectus (SI)	Median Total Expense% Prospectus (SI)
Conservative Allocation	A	1.24	1.18
	Inst	0.98	0.90
	Ret	1.40	1.38
Moderate Allocation	A	1.32	1.28
	Inst	1.01	0.96
	Ret	1.32	1.40
Foreign Large Value	A	1.45	1.45
	Inst	1.02	1.02
	Ret	1.52	1.60
Foreign Large Blend	A	1.50	1.48
	Inst	1.10	1.13
	Ret	1.40	1.48
Foreign Large Growth	A	1.56	1.53
	Inst	1.16	1.15
	Ret	1.60	1.63
World Stock	A	1.57	1.50
	Inst	1.17	1.15
	Ret	1.58	1.58
Interm-Term Bond	A	0.94	0.91
	Inst	0.62	0.59
	Ret	1.06	1.13
Short-Term Bond	A	0.89	0.86
	Inst	0.57	0.54
	Ret	0.98	1.01

(SI) Source: Strategic Insight  
(MS) Source: Morningstar

Data Source: SIMFUND® (Strategic Insight)  
data provided based on current release date  
of December 31, 2010.

**SCHEDULE C  
(Form 5500)**

Department of the Treasury  
Internal Revenue Service

Department of Labor  
Employee Benefits Security Administration

Pension Benefit Guaranty Corporation

**Service Provider Information**

This schedule is required to be filed under section 104 of the Employee Retirement Income Security Act of 1974 (ERISA).

▶ **File as an attachment to Form 5500.**

OMB No. 1210-0110

**2010**

**This Form is Open to Public Inspection.**

For calendar plan year 2010 or fiscal plan year beginning \_\_\_\_\_ and ending \_\_\_\_\_

<b>A</b> Name of plan	<b>B</b> Three-digit plan number (PN) ▶	
<b>C</b> Plan sponsor's name as shown on line 2a of Form 5500	<b>D</b> Employer Identification Number (EIN)	

**Part I Service Provider Information (see instructions)**

You must complete this Part, in accordance with the instructions, to report the information required for **each person** who received, directly or indirectly, \$5,000 or more in total compensation (i.e., money or anything else of monetary value) in connection with services rendered to the plan or the person's position with the plan during the plan year. If a person received **only** eligible indirect compensation for which the plan received the required disclosures, you are required to answer line 1 but are not required to include that person when completing the remainder of this Part.

**1 Information on Persons Receiving Only Eligible Indirect Compensation**

**a** Check "Yes" or "No" to indicate whether you are excluding a person from the remainder of this Part because they received only eligible indirect compensation for which the plan received the required disclosures (see instructions for definitions and conditions).....  Yes  No

**b** If you answered line 1a "Yes," enter the name and EIN or address of each person providing the required disclosures for the service providers who received only eligible indirect compensation. Complete as many entries as needed (see instructions).

(b) Enter name and EIN or address of person who provided you disclosures on eligible indirect compensation

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## DOL Model Comparative Chart

The DOL offers plan sponsors a model comparative chart for creating to disclosures participants. You can find the complete model at [www.dol.gov/ebsa/participantfeerulemodelchart.doc](http://www.dol.gov/ebsa/participantfeerulemodelchart.doc). Sponsors can add information to the basic framework, as long as it's accurate and not misleading.

Two sample sections from the model follow:

### Sample Fee and Expense Information for Plan Investment Options

Fees and Expenses		
Name / Type of Investment Option	Total Annual Operating Expenses As a % Per \$1,000	Shareholder-Type Fees
Equity Funds		
A Index Fund/ S&P 500	0.18% \$1.80	\$20 annual service charge subtracted from investments held in this option if valued at less than \$10,000.
D Fund/ Mid Cap ETF	0.20% \$2.00	4.25% sales charge subtracted from amounts withdrawn.
Bond Funds		
E Fund/ Bond Index	0.50% \$5.00	N/A
Other		
G Fund/Stable Value	0.65% \$6.50	Amounts withdrawn may not be transferred to a competing option for 90 days after withdrawal.
Generations 2020/ Lifecycle Fund	1.50% \$15.00	Excessive trading restricts additional purchases (other than contributions and loan repayments) for 85 days.
Fixed Return Investments		
H 200X / GIC	N/A	12% charge subtracted from amounts withdrawn before maturity.
I LIBOR Plus/ Fixed-Type Invest Account	N/A	5% contingent deferred sales charge subtracted from amounts withdrawn; charge reduced by 1% on 12-month anniversary of each investment.

Source: Department of Labor Model Chart (abridged)



## Sample Annuity Disclosure

Annuity Options			
Name	Objectives / Goals	Pricing Factors	Restrictions / Fees
Lifetime Income Option web site address	To provide a guaranteed stream of income for your life based on shares you acquire while you work. At age 65 you will receive monthly payments of \$10 for each share you own, for your life. For example, if you own 30 shares at age 65, you will receive \$300 per month over your life.	<p>The cost of each share depends on your age and interest rates when you buy it. Ordinarily the closer you are to retirement, the more it will cost you to buy a share.</p> <p>The cost includes a guaranteed death benefit payable to a spouse or beneficiary if you die before payments begin. The death benefit is the total amount of your contributions, less any withdrawals.</p>	<p>Payment amounts are based on your life expectancy only and would be reduced if you choose a spousal joint and survivor benefit.</p> <p>You will pay a 25% surrender charge for any amount you withdraw before annuity payments begin.</p> <p>If your income payments are less than \$50 per month, the option's issuer may combine payments and pay you less frequently, or return to you the larger of your net contributions or the cash-out value of your income shares.</p>

Source: Department of Labor Model Chart (abridged)

## Disclosure and Schedule C Differences

There are a number of similarities and differences between the reporting of plan fees on the 5500 Schedule C and the requirements of the Interim Final Service Provider Disclosure Regulation. The following table review the major differences between the two.

5500 Schedule C	Service Provider Disclosure Regulation
<b>Purpose</b>	
Increase transparency of plan fees	Clarify how contract qualifies for prohibited transaction exemption
<b>Plan Type</b>	
ERISA Retirement and Welfare Plans (SEPs, SIMPLE IRAs or IRAs Excluded)	ERISA Retirement Plans (SEPs, SIMPLE IRAs or IRAs Excluded)
<b>Plan Size</b>	
100 or more participants	No limitation
<b>Covered Providers</b>	
No service criteria	Select based on services
<b>Provider Compensation Threshold</b>	
\$5,000	\$1,000
<b>Covered Periods</b>	
Looking back to prior Plan Year	Looking forward in advance of contract
<b>Effective Date</b>	
2009 Plan Year	1-Jan-12
<b>Noncompliance Reporting</b>	
Annually	30 days of refusal or 90 days from request

Source: SPARK 2011 Course Study Guide: Retirement Plan Fee Reporting and Disclosure Requirements

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