

Fee Disclosure and Plan Benchmarking for DC Plans

A presentation to PEBA

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November 17, 2010

DOL Rules on Service Provider Fee Disclosure under ERISA 408(b)(2)

- Basic Rule

New Regulations State:

- Certain service providers must provide fee disclosures to the defined benefit and defined contribution plan fiduciaries that are responsible for hiring and monitoring such providers
- Applies to compensation reasonably expected to be received
- Rule is effective as of July 16, 2011
 - With respect to contracts already in effect on July 16, 2011, disclosures have to be made as of such date

DOL Rules on Service Provider Fee Disclosure under ERISA 408(b)(2)

- Basic Rule
- Service Providers

The rules apply to:

- All ERISA DB and DC plans
- Covered service providers (CSP) perform
 - fiduciary services
 - recordkeeping services
 - other services (Accounting, legal, actuarial, legal, custodial, investment consulting, etc.)
 - Only applies if CSP, affiliate or subcontractor receives indirect compensation or compensation from related parties
- Direct Compensation
 - Received directly from the Plan (or plan sponsor)
- Indirect Compensation
 - Received from any source other than Plan, plan sponsor, CSP, affiliate, or subcontractor
- Rule is distinct from Form 5500 Schedule C requirements, which is not limited to direct service providers and has higher compensation threshold (\$5,000 compared to \$250)

DOL Rules on Service Provider Fee Disclosure under ERISA 408(b)(2)

- Basic Rule
- Service Providers
- Fiduciary Requirements

Although burden is on vendors to disclose information, fiduciaries still must evaluate reasonableness of fees :

- To understand information, gaps and reasonableness of fees, we recommend a fee analysis and benchmarking review
- Important for fiduciaries to document their fee review process

What Should Plan Sponsors Do?

Included at the DOL website is the following statement:

You should be aware that your employer also has a specific obligation to consider the fees and expenses paid by your plan. ERISA requires employers to follow certain rules in managing 401(k) plans. Employers are held to a high standard of care and diligence and must discharge their duties solely in the interest of the plan participants and their beneficiaries.

Among other things, this means that employers must:

- Establish a prudent process for selecting investment alternatives and service providers
- Ensure that fees paid to service providers and other expenses of the plan are reasonable in light of the level and quality of services provided
- Select investment alternatives that are prudent and adequately diversified
- Monitor investment alternatives and service providers once selected to see that they continue to be appropriate choices.

Fee Disclosure and Benchmarking

- Towers Watson's **Fee Disclosure & Benchmarking Analysis** is designed to assist plan sponsors in uncovering all fees associated with their retirement plan and benchmarking those fees against recent vendor searches and contract reviews that we have performed for plans that are comparable in size and complexity.
 - Utilizes plans across multiple vendors to create a more diverse cross section
- This analysis will help plan sponsors determine whether their fees and expenses are reasonable and competitive in today's marketplace.
 - Results provide plan fiduciaries with an recommendations for changes that could result in reduced fees and/or better value for plan participants
- This analysis will help plan sponsors understand their current fee arrangements and satisfy their fiduciary requirements to determine if fees are "reasonable"
 - Plan fiduciaries should complete benchmarking every few years or as plan dynamics change.

Towers Watson Approach to Fee Benchmarking

- Identify all investment related fees, front-end and deferred sales charges, 12b-1 fees and annuity contract charges.
- Identify communication costs such as enrollment meetings and material charges, and all explicit administration and recordkeeping charges.

Inventory Fees & Revenue

- Benchmark the fees currently paid based on recent vendor searches and contract reviews for plans that are comparable in size and complexity - includes hard dollar fees, the fund investment management fees (expense ratios), and fee sharing arrangements.

Conduct Competitive Fee Assessment

- Review the expense ratios associated with the current line-up and comment on the reasonableness of these expenses versus industry benchmarks for plans that are comparable in size.

Review Expense Ratios

- Mutual funds may offer several different share classes, all within the same portfolio. We will research the “lowest available share class” and analyze the impact of using lower cost options to total plan expenses.

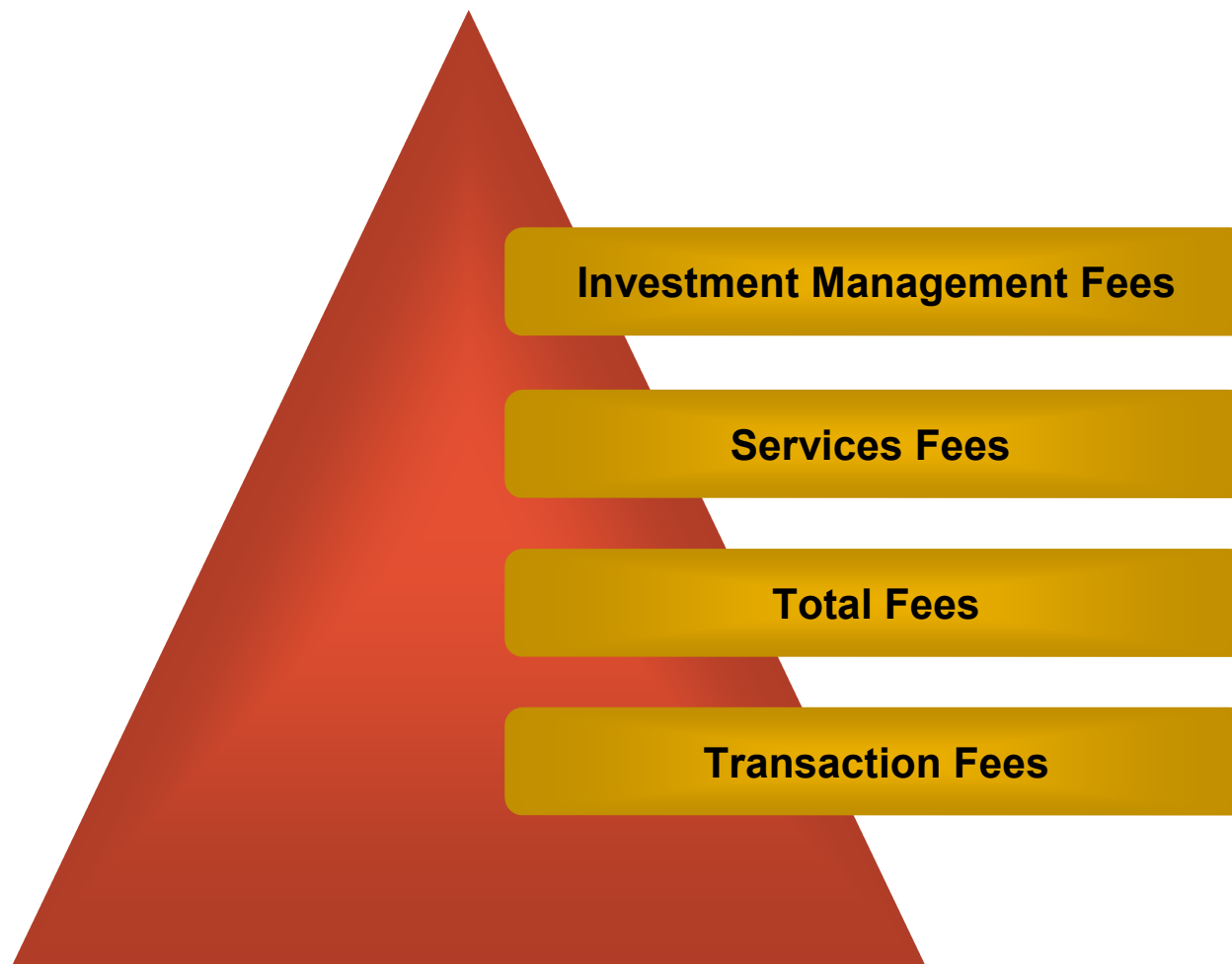
Review Share Classes

- Benchmark the services provided by your service provider to those offered by other major outsourcers based on the Towers Watson vendor database, recent vendor searches, and contract reviews for plans that are comparable in size and complexity.

Conduct Competitive Service Assessment

Towers Watson Approach to Fee Benchmarking

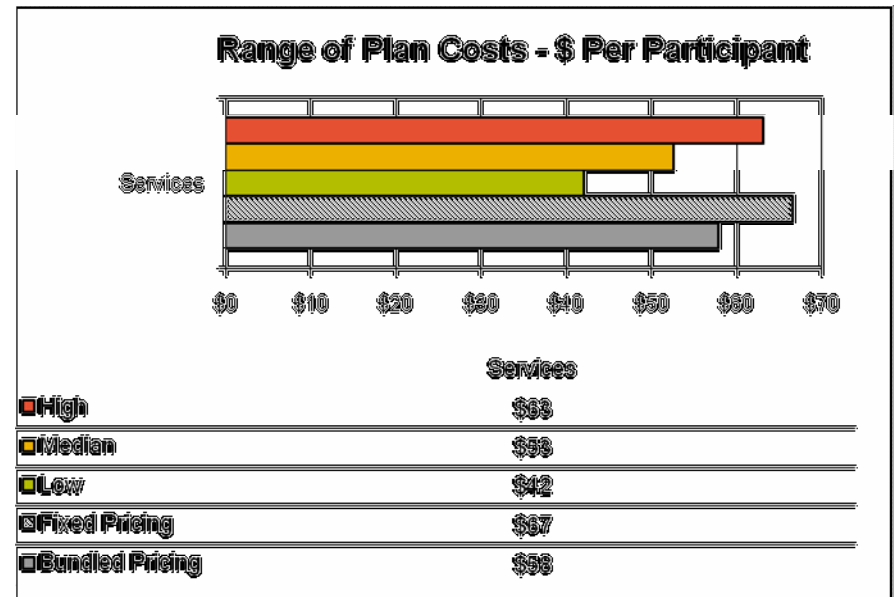
Key areas to review



Fee Allocations and Structures

Serviced based fees

- Comprised of participant-based costs and transaction based fees
- Costs generally paid via
 - Hard dollar fees
 - Revenue sharing
- Benchmark service fees with plans that have similar
 - Number of participants
 - Average account balances
 - Complexity
 - Employee education and communications



Representative sample from TW benchmarking study

Fee Allocations and Structures

Investment based fees

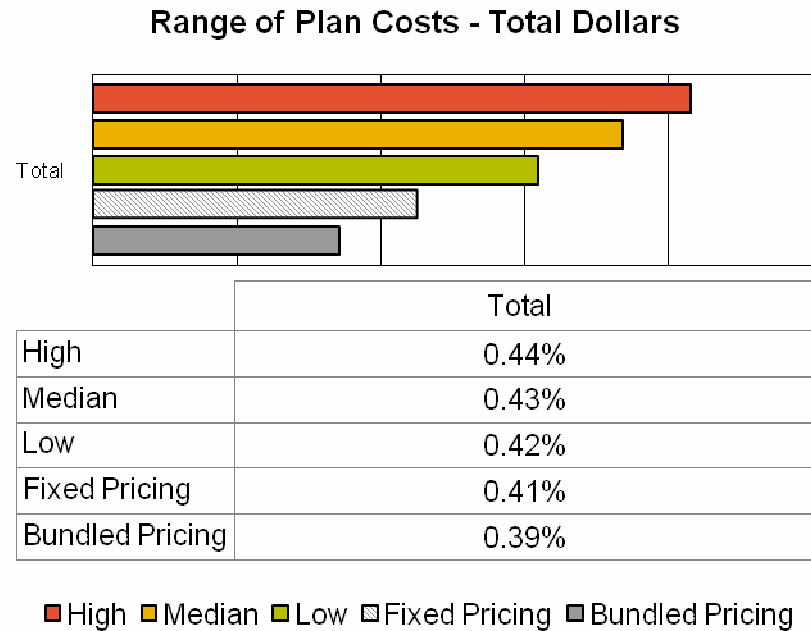
- Benchmark investment options against comparable solutions
 - Asset class
 - Asset size
 - Management style (active versus passive)
- Identify lower share class investment options if appropriate

Benchmarks generally ignore quality

Fee Allocations and Structures

Total fees

- Total fees = service fees + transaction fees + investment management fees
 - Usually measured as a percentage of plan assets
- Total costs should be benchmarked against comparable asset allocations



Representative sample from TW benchmarking study

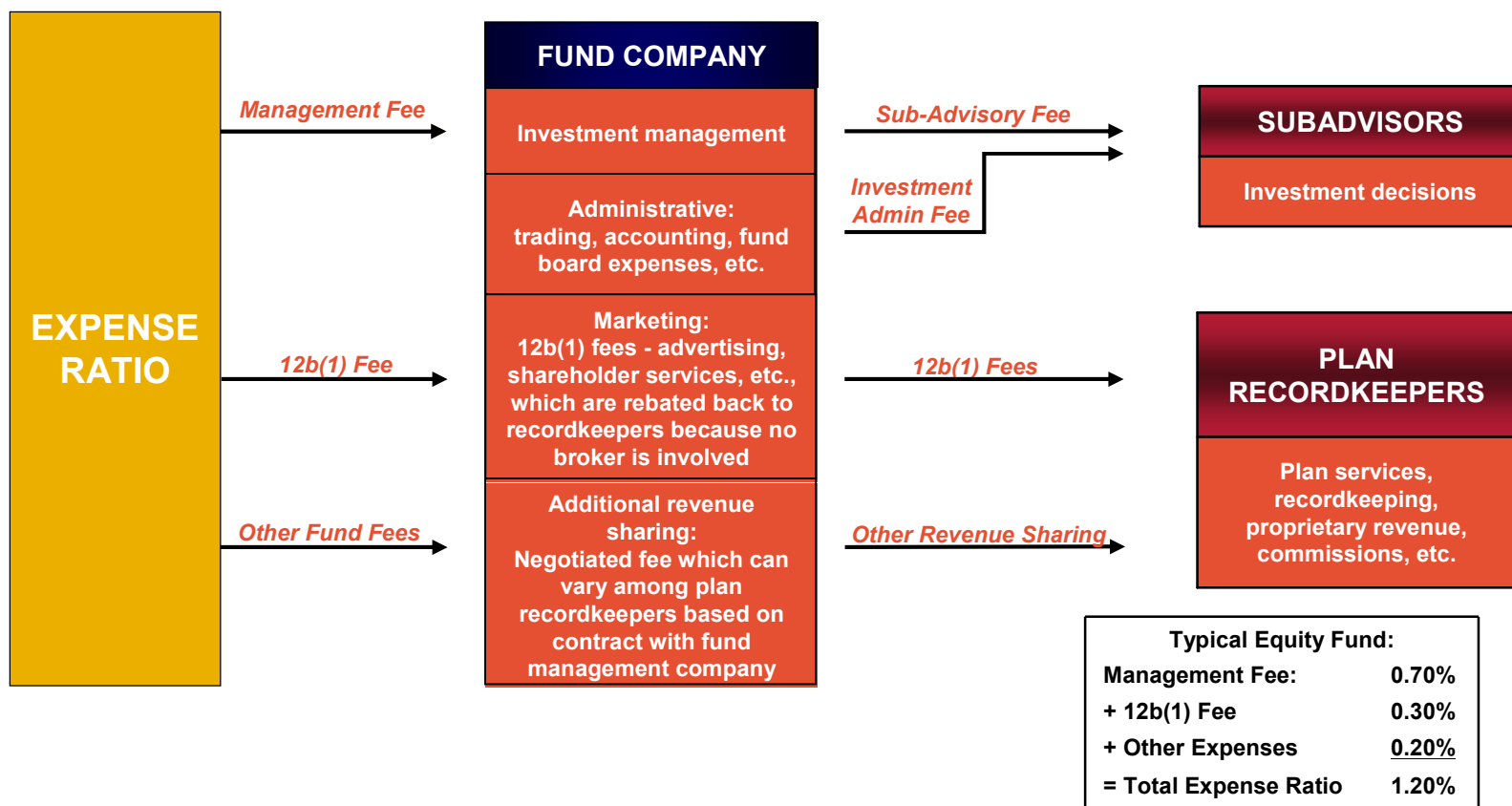
Fee Allocations and Structures

Revenue sharing considerations

- “Proprietary” options typically pay more revenue sharing
 - Proprietary options – Investments offered by service provider
- Proprietary revenue sharing may receive more favorable pricing due to enhancement of service vendor’s overall brand
- Revenue sharing
 - May create a windfall for recordkeeper when assets rise absent renegotiation of services and/or changes in investments
 - Creates inherent potential for inequitable allocation of fees unless all options provide same rate

Mutual Fund Expenses and Revenue Sharing

Flow of fees from participant accounts to retirement plan service providers



Fee Disclosure & Benchmarking

- Project outcomes

- During the past 3 years we have conducted over 75 Fee Disclosure and Benchmarking Projects
- On average fee reductions for our clients have been 20%-30%, with some exceeding 50%
- Savings will vary based on:
 - Plan vendor to be evaluated
 - Duration since last fee review and contract negotiation
 - Change in plan value and other statistics since last contract and fee review.
- Other outcomes:
 - Implementation of service standards and performance guarantees
 - Revised contract terms
 - Improved investment offering for plan participants
 - Satisfaction of fiduciary due diligence requirements

Case Studies

Case Study #1

- Bundled administration
- Plan assets \$11 billion
- 100,000 participants
- 45 investment funds
 - Mutual funds
 - Collective trusts
 - Separate accounts
 - Company stock
- Annual fee reduction of **\$4.5 million**

Case Study #2

- Un-bundled administration
- Plan assets \$4.5 billion
- 85,000 participants
- 14 investment funds
 - Mutual funds
 - Collective trusts
 - Separate accounts
 - Company stock
- Annual fee reduction of **\$3.2 million**

Case Study #3

- Bundled administration
- Plan assets \$600 million
- 8,000 participants
- 12 investment funds
 - Mutual funds
 - Collective trusts
 - Separate accounts
 - Company stock
- Annual fee reduction of **\$0.9 million**

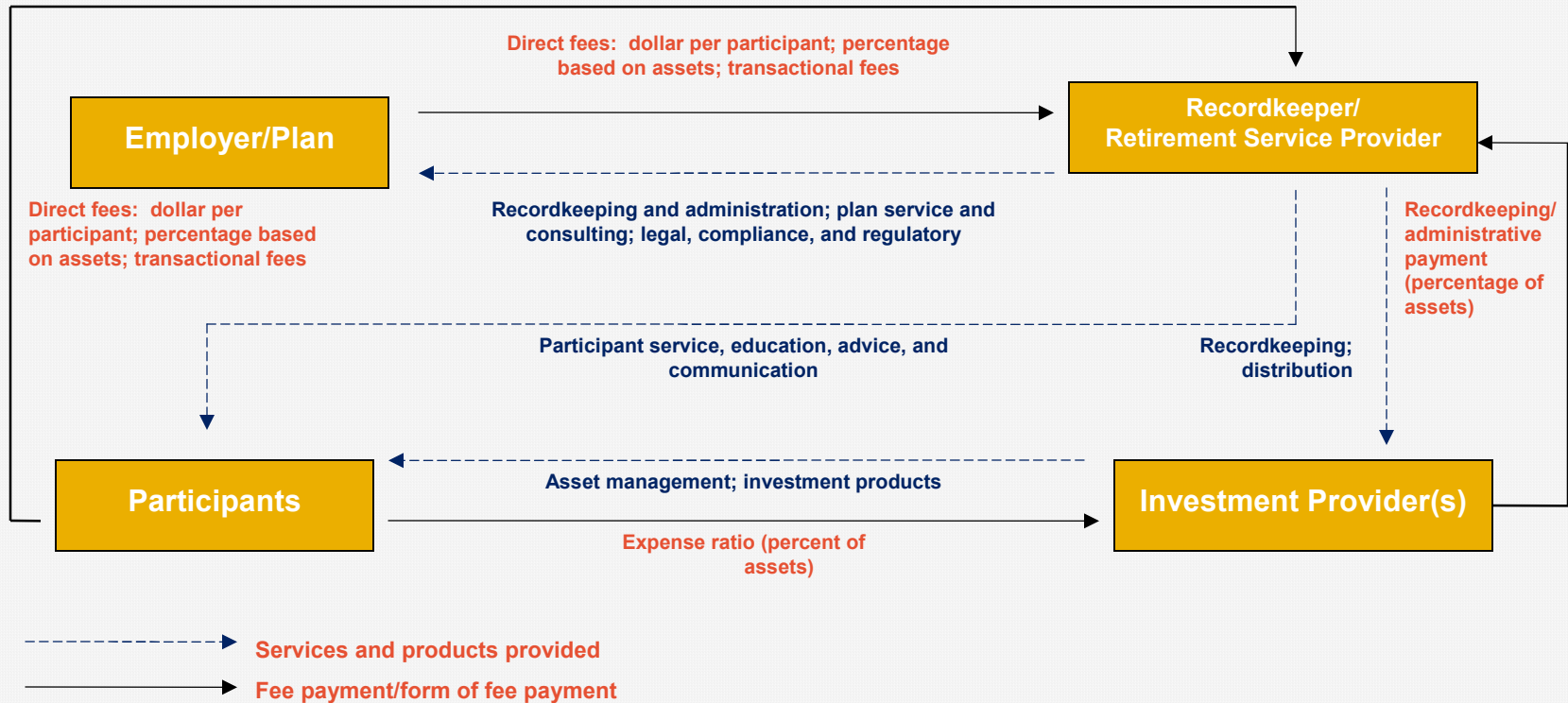
In each case, these results were achieved with the incumbent vendor, and included successful negotiations of otherwise non-negotiable fee and service provisions.

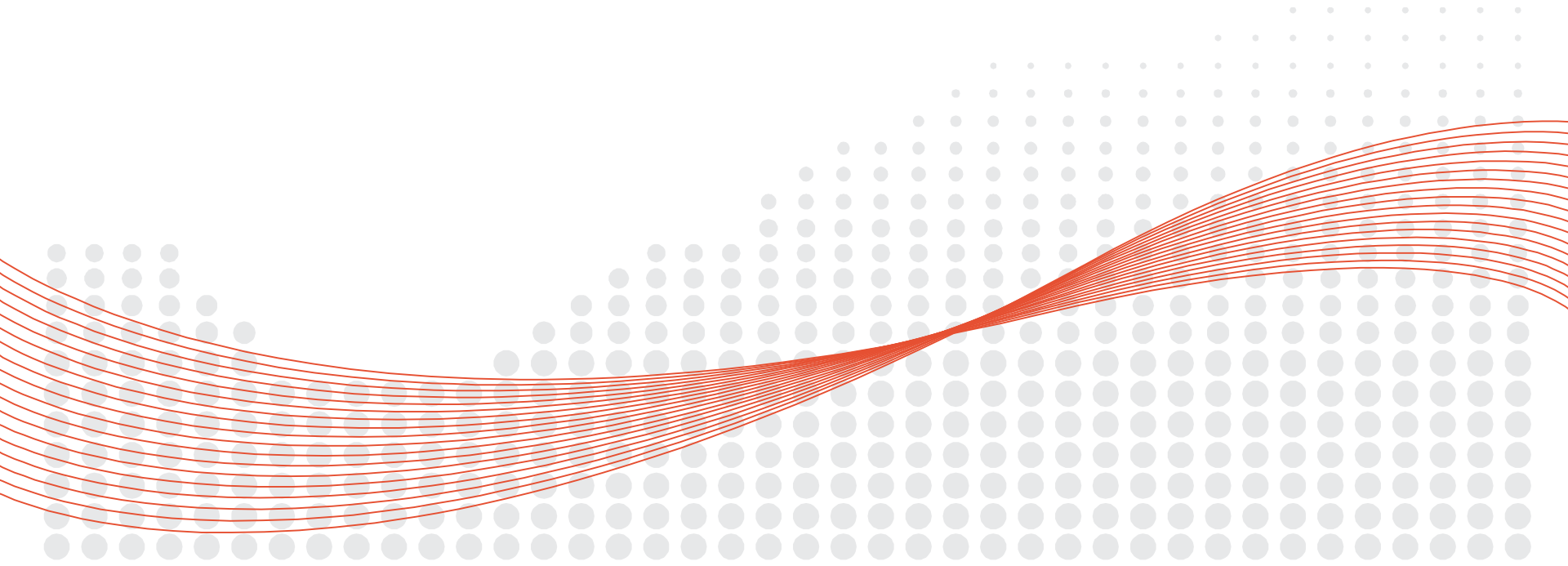


Appendix A– Fee Sources

Sources of DC Plan Provider Fees

(from ICI DC/401(k) Fee Study, 2009)





Towers Watson

Towers Watson Experience

Now that the DOL has provided Fee Disclosure requirements it has become even more critical for plan sponsors to understand fees associated with their defined contribution plans.

Our dedicated Benefits Advisory and Compliance (BAC) consultants help plan sponsors effectively manage their retirement and health and welfare programs. The BAC team consists of over 80 experienced consultants.

Towers Watson BAC consultants have:

- Expertise in compliance, administration, defined contribution consulting and vendor consulting
- Deep experience working with organizations of all types and sizes
- Provide integrated services to help you mitigate risk and improve the value you deliver to plan participants
- Developed tools and templates to allow for efficient process
- Completed over 150 benchmark studies in the last 2 years

BAC services include:

- Operational Consulting
 - Compliance Reviews
 - Process Reviews
 - Payroll Reviews
 - Governance Reviews
- Compliance Services
 - Plan document and administrative form review & drafting
 - Government form processing
 - Discrimination testing
- Vendor Consulting
 - Search and Selection
 - Fee Benchmarking
 - Contract review & negotiation
- Defined Contribution Consulting
- Nonqualified Plan Consulting

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