

A
LOOK
AT

401(k)

PLAN
FEES



U.S. DEPARTMENT
OF LABOR
EMPLOYEE
BENEFITS SECURITY
ADMINISTRATION

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Introduction

More and more employees are investing in their futures through 401(k) plans. Employees who participate in 401(k) plans assume responsibility for their retirement income by contributing part of their salary and, in many instances, by directing their own investments.

If you are among those who direct your investments, you will need to consider the investment objectives, the risk and return characteristics, and the performance over time of each investment option offered by your plan in order to make sound investment decisions. Fees and expenses are one of the factors that will affect your investment returns and will impact your retirement income.

The information contained in this booklet answers some common questions about the fees and expenses that may be paid by your 401(k) plan. It highlights the most common fees and encourages you, as a 401(k) plan participant, to:

- make informed investment decisions;
- consider fees as one of several factors in your decision making;
- compare all services received with the total cost; and
- realize that cheaper is not necessarily better.

Keep in mind, however, that this booklet is a simplified explanation of 401(k) fees. It is not a legal interpretation of the nation's major pension

protection law, the Employee Retirement Income Security Act (ERISA), or other laws, nor is this information intended to be investment advice.

1. *Why consider fees?*

In a 401(k) plan, your account balance will determine the amount of retirement income you will receive from the plan. While contributions to your account and the earnings on your investments will increase your retirement income, fees and expenses paid by your plan may substantially reduce the growth in your account. The following example demonstrates how fees and expenses can impact your account.

Assume that you are an employee with 35 years until retirement and a current 401(k) account balance of \$25,000. If returns on investments in your account over the next 35 years average 7 percent and fees and expenses reduce your average returns by 0.5 percent, your account balance will grow to \$227,000 at retirement, even if there are no further contributions to your account. If fees and expenses are 1.5 percent, however, your account balance will grow to only \$163,000. The 1 percent difference in fees and expenses would reduce your account balance at retirement by 28 percent.

In recent years, there has been a dramatic increase in the number of investment options typically offered under 401(k) plans as well as the level and types of services provided to participants. These changes give today's employees who direct their 401(k) investments greater opportunity than ever before to affect their retirement savings. As a participant you may welcome the variety of investment alternatives and the additional services,

but you may not be aware of their cost. As shown above, the cumulative effect of the fees and expenses on your retirement savings can be substantial.

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; and
- ◆ Monitor investment alternatives and service providers once selected to see that they continue to be appropriate choices.

2. What are 401(k) plan fees and who pays for them?

If you want to know how fees affect your retirement savings, you will need to know about the different types of fees and expenses and the different ways in which they are charged.

401(k) plan fees and expenses generally fall into three categories:

Plan administration fees. The day-to-day operation of a 401(k) plan involves expenses for basic administrative services -- such as plan record-keeping, accounting, legal and trustee services -- that are necessary for administering the plan as a whole. Today, a 401(k) plan also may offer a host of additional services, such as telephone voice-response systems, access to a customer service representative, educational seminars, retirement planning software, investment advice, electronic access to plan information, daily valuation and online transactions.

In some instances, the costs of administrative services will be covered by investment fees that are deducted directly from investment returns. Otherwise, if administrative costs are separately charged, they will be borne either by your employer or charged directly against the assets of the plan. When paid directly by the plan, administrative fees are either allocated among individual accounts in proportion to each account balance (i.e., participants with larger account balances pay more of the allocated expenses) or passed through as a flat fee against each participant's account. Either way, generally the more services provided, the higher the fees.

Investment fees. By far the largest component of 401(k) plan fees and expenses is associated with managing plan investments. Fees for investment management and other investment-related services generally are assessed as a percentage of assets invested. You should pay attention to these fees. You pay for them in the form of an indirect charge against

your account because they are deducted directly from your investment returns. Your net total return is your return after these fees have been deducted. For this reason, these fees, which are not specifically identified on statements of investments, may not be immediately apparent. *(See pages 6-10 for more information on investment-related fees.)*

Individual service fees. In addition to overall administrative expenses, there may be individual service fees associated with optional features offered under a 401(k) plan. Individual service fees are charged separately to the accounts of individuals who choose to take advantage of a particular plan feature. For example, individual service fees may be charged to a participant for taking a loan from the plan or for executing participant investment directions.

401(k) plan investments and services may be provided through a variety of arrangements:

Employers may directly provide, or separately negotiate for, some or all of the various services and investment alternatives offered under their 401(k) plans (sometimes referred to as an unbundled arrangement). The expenses of each provider (i.e., investment manager, trustee, recordkeeper, communications firm) are charged separately.

In many plans, some or all of the various services and investment alternatives may be offered by one provider for a fee paid to that provider (sometimes referred to as a bundled arrangement). The provider

will then pay out of that fee any other service providers that it may have contracted to provide the services.

Some plans may use an arrangement that combines a single provider for certain services, such as administrative services, with a number of providers for investment options.

Fees need to be evaluated, keeping in mind the cost of all covered services.

3. What fees are associated with my investment choices in a 401(k) plan?

Apart from fees charged for administration of the plan itself, there are three basic types of fees that may be charged in connection with investment alternatives in a 401(k) plan. These fees, which can be referred to by different terms, include:

- ◆ **Sales charges** (also known as **loads** or **commissions**). These are basically transaction costs for the buying and selling of shares. They may be computed in different ways, depending upon the particular investment product.

- ◆ **Management fees** (also known as **investment advisory fees** or **account maintenance fees**). These are ongoing charges for managing the assets of the investment fund. They are generally stated as a percentage of the amount of assets invested in the fund. Sometimes

management fees may be used to cover administrative expenses. You should know that the level of management fees can vary widely, depending on the investment manager and the nature of the investment product. Investment products that require significant management, research and monitoring services generally will have higher fees. (*See page 12.*)

- ◆ **Other fees.** This category covers services, such as recordkeeping, furnishing statements, toll-free telephone numbers and investment advice, involved in the day-to-day management of investment products. They may be stated either as a flat fee or as a percentage of the amount of assets invested in the fund.

In addition, there are some fees that are unique to specific types of investments. Following are brief descriptions of some of the more common investments offered under 401(k) plans and explanations of some of the different terminology and unique fees associated with them.

Some Common Investments and Related Fees

Most investments offered under 401(k) plans today pool the money of a large number of individual investors. Pooling money makes it possible for individual participants to diversify investments, to benefit from economies of scale and to lower their

transaction costs. These funds may invest in stocks, bonds, real estate and other investments. Larger plans, by virtue of their size, are more likely to pool investments on their own -- for example, by using a separate account held with a financial institution. Smaller plans generally invest in commingled pooled investment vehicles offered by financial institutions, such as banks, insurance companies or mutual funds. Generally, investment-related fees, usually charged as a percentage of assets invested, are paid by the participant.

Mutual funds. Mutual funds pool and invest the money of many people. Each investor owns shares in the mutual fund that represent a part of the mutual fund's holdings. The portfolio of securities held by a mutual fund is managed by a professional investment adviser following a specific investment policy. In addition to investment management and administration fees, you may find these fees:

- ◆ Some mutual funds assess sales charges (see above for a discussion of sales charges). These charges may be paid when you invest in a fund (known as a **front-end load**) or when you sell shares (known as a **back-end load, deferred sales charge or redemption fee**). A front-end load is deducted up front and, therefore, reduces the amount of your initial investment. A back-end load is determined by how long you keep your investment. There are various types of back-end loads, including some which decrease and eventually disappear over time. A back-end load is paid when the

shares are sold (i.e., if you decide to sell a fund share when a back-end load is in effect, you will be charged the load).

- ◆ Mutual funds also may charge what are known as **Rule 12b-1** fees, which are ongoing fees paid out of fund assets. Rule 12b-1 fees may be used to pay commissions to brokers and other salespersons, to pay for advertising and other costs of promoting the fund to investors and to pay various service providers of a 401(k) plan pursuant to a bundled services arrangement. They are usually between 0.25 percent and 1.00 percent of assets annually.
- ◆ Some mutual funds may be advertised as “no-load” funds. This can mean that there is no front- or back-end load. However, there may be a small 12b-1 fee.

Collective investment funds. A collective investment fund is a trust fund managed by a bank or trust company that pools investments of 401(k) plans and other similar investors. Each investor has a proportionate interest in the trust fund assets. For example, if a collective investment fund holds \$10 million in assets and your investment in the fund is \$10,000, you have a 0.1 percent interest in the fund. Like mutual funds, collective investment funds may have different investment objectives. There are no front- or back-end fees associated with a collective investment fund, but there are investment management and administrative fees.

Variable annuities. Insurance companies frequently offer a range of investment alternatives for 401(k) plans through a group variable annuity contract between an insurance company and an employer on behalf of a plan. The variable annuity contract “wraps” around investment alternatives, often a number of mutual funds. Participants select from among the investment alternatives offered, and the returns to their individual accounts vary with their choice of investments. Variable annuities also include one or more insurance elements, which are not present in other investment alternatives. Generally, these elements include an annuity feature, interest and expense guarantees, and any death benefit provided during the term of the contract. In addition to investment management fees and administration fees, you may find these fees:

- ◆ **Insurance-related charges** are associated with investment alternatives that include an insurance component. They include items such as sales expenses, mortality risk charges and the cost of issuing and administering contracts.
- ◆ **Surrender and transfer charges** are fees an insurance company may charge when an employer terminates a contract (in other words, withdraws the plan’s investment) before the term of the contract expires or if you withdraw an amount from the contract. This fee may be imposed if these events occur before the expiration of a stated

period, and commonly decrease and disappear over time. It is similar to an early withdrawal penalty on a bank certificate of deposit or to a back-end load or redemption fee charged by some mutual funds.

Pooled guaranteed investment contract (GIC) funds. A common fixed income investment option, a pooled GIC fund generally includes a number of contracts issued by an insurance company or bank paying an interest rate that blends the fixed interest rates of each of the GICs included in the pool. There are investment management and administrative fees associated with the pooled GIC fund.

While the investments described above are common, 401(k) plans also may offer other investments which are not described here (such as employer securities).

4. Where can I get information about the fees and expenses charged to my 401(k) plan account?

If you have questions about the fees and expenses charged to your 401(k) plan, contact your plan administrator, who should be able to assist you with the following documents:

- ◆ If your plan permits you to direct the investment of assets in your account, the plan administrator should provide you with copies of documents describing investment management and other fees associated with

each of the investment alternatives available to you (i.e., a prospectus). The plan administrator should also provide a description of any transaction fees and expenses that will be charged against your account balance in connection with the investments you direct.

- ◆ Your **account statement** will show the total assets in your account, how they are invested and any increases (or decreases) in your investments during the period covered by the statement. It may also show administrative expenses charged to your account. Account statements will be provided once a year upon request, unless your plan document provides otherwise.
- ◆ Your 401(k) plan's **summary plan description (SPD)** will tell you what the plan provides and how it operates. It may tell you if administrative expenses are paid by your plan, rather than by your employer, and how those expenses are allocated among plan participants. A copy of the SPD is furnished to participants when they join a plan and every 5 years if there are material modifications or every 10 years if there is no modification.
- ◆ The plan's **annual report (Form 5500 series)** contains information regarding the plan's assets, liabilities, income and expenses and shows the aggregate administrative fees and other expenses paid by the plan. However, it will not show

expenses deducted from investment results or fees and expenses paid by your individual account. Fees paid by your employer also will not be shown. You may examine the annual report for free or request a copy from the plan administrator (for which there may be a charge). In general, the **summary annual report**, which summarizes the annual report information, is distributed each year.

In addition, you may want to consult the business section of major daily newspapers, business and financial publications, rating services, the business librarian at the public library, or the Internet (see the list of helpful Websites at the back of this booklet). These sources will provide information and help you compare the performance and expenses of your investment options with other investments outside of your 401(k) plan.

If, after doing your own analysis, you have questions regarding the rates of return or fees of your plan's investment options, ask your plan administrator for an explanation.

5. What other factors might impact the fees and expenses of my 401(k) plan?

- Funds that are “actively managed” (i.e., funds with an investment adviser who continually researches, monitors, and actively trades the holdings of the fund to seek a higher return than the market) generally have higher fees. The higher fees are associated with the more active

management provided and sales charges from the higher level of trading activity. While actively managed funds seek to provide higher returns than the market, neither active management nor higher fees necessarily guarantee higher returns.

- Funds that are “passively managed” generally have lower management fees. Passively managed funds seek to obtain the investment results of an established market index, such as the Standard and Poor’s 500, by duplicating the holdings included in the index. Thus, passively managed funds require little research or trading activity.
- If the services and investment alternatives under your plan are offered through a bundled program, then some or all of the costs of plan services may not be separately charged to the plan or to your employer. For example, these costs possibly may be subsidized by the asset-based fees charged on investments. Compare the services received in light of the total fees paid.
- Plans with more total assets may be able to lower fees by using special funds or classes of stock in funds, which generally are sold to larger group investors. “Retail” or “brand name” funds, which are also marketed to

individual and small group investors, tend to be listed in the newspaper daily and typically charge higher fees. Let your employer know your preference.

- Optional features, such as participant loan programs and insurance benefits offered under variable annuity contracts, involve additional costs. Consider whether they have value to you. If not, let your employer know.
- Retirement plans, such as 401(k) plans, are group plans. Therefore, your employer may not be able to accommodate each employee's preferences for investment alternatives or additional services.

6. Is there a checklist I can use to review my 401(k) plan's fees?

There are an array of investment options and services offered under today's 401(k) plans. While there is no easy way to calculate the fees and expenses paid by your 401(k) plan due to the number of variables involved, you can begin by asking yourself questions and, if you cannot find the answers, by asking your plan administrator. Answers to the following 10 questions will help in gathering information about the fees and expenses paid by your plan.

401(k) Fees Checklist

- 1 What investment options are offered under your company's 401(k) plan?

- 2 Do you have all available documentation about the investment choices under your plan and the fees charged to your plan?
- 3 What types of investment education are available under your plan?
- 4 What arrangement is used to provide services under your plan (i.e., are any or all of the services or investment alternatives provided by a single provider)?
- 5 Do you and other participants use most or all of the optional services offered under your 401(k) plan, such as participant loan programs and insurance coverages?
- 6 If administrative services are paid separately from investment management fees, are they paid for by the plan, your employer, or are they shared?
- 7 Are the investment options tracking an established market index or is there a higher level of investment management services being provided?
- 8 Do any of the investment options under your plan include sales charges (such as loads or commissions)?
- 9 Do any of the investment options under your plan include any fees related to specific investments, such as 12b-1 fees, insurance charges or surrender fees, and what do they cover?

10 Does your plan offer any special funds or special classes of stock (generally sold to larger group investors)?

This booklet is only the beginning of your educational process. You should ask questions and educate yourself about investments. Monitoring your current investment selections and reviewing the investment alternatives offered under your plan are part of a process that you, as an informed participant, will need to undertake continually.

Keep in mind that the law requires the fees charged to a 401(k) plan be “reasonable” rather than setting a specific level of fees that are permissible. Therefore, the reasonableness of fees must be determined in each case.

For additional information regarding the level of fees typically charged to 401(k) plans and 401(k) plan fees and expenses generally, see the Employee Benefits Security Administration’s *Study of 401(k) Plan Fees and Expenses*, available on EBSA’s Website at www.dol.gov/ebsa

In Conclusion ...

When you consider the fees in your 401(k) plan and their impact on your retirement income, remember that **all services have costs**. If your employer has selected a bundled program of services and investments, **compare all services received with the total cost**.

Remember, too, that higher investment management fees do not necessarily mean better performance. Nor is cheaper necessarily better. **Compare the net returns relative to the risks among available investment options.**

And, finally, **don't consider fees in a vacuum.** They are only one part of the bigger picture including investment risk and returns and the extent and quality of services provided.

7. What other sources of information are available?

Listed below are some organizations and their Websites, phone numbers and publications that can help in your research.

From the **Employee Benefits Security Administration:**

What You Should Know About Your Retirement Plan

Website:

www.dol.gov/ebsa

Toll-free Publication Hotline:

1-866-444-EBSA (3272)

Among the items available on EBSA's Website is

Study of 401(k) Plan Fees and Expenses
(available only on the Internet)

From the **Securities and Exchange Commission:**

Get the Facts on Savings and Investing

Invest Wisely - An Introduction to Mutual Funds

*Ask Questions - Questions You Should
Ask About Your Investments ... and What
To Do if You Run into Problems*

Website:

www.sec.gov

Toll-free phone information service:

1-800-732-0330

From the **Board of Governors of the Federal
Reserve System:**

Website:

www.federalreserve.gov

From the **Comptroller of the Currency:**

Website:

www.occ.treas.gov

From the **American Savings Education Council
(ASEC):**

Website:

www.choosetosave.org/asec

Phone:

(202) 659-0670

From the **Certified Financial Planner Board of
Standards:**

Website:

www.cfp.net

Phone:

1-888-237-6275 (toll-free)

From the **National Association of Securities
Dealers, Inc.:**

Website:

www.nasd.com

