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401(k) Plan Expenses

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Under a 401(k) plan, your benefit is your vested account balance. This account balance reflects the contributions you make to the plan, the contributions your employer makes to the plan on your behalf (if any), and investment gains and losses.

Many 401(k) plan participants are responsible for choosing how to invest their account balances. If you direct the investment of your 401(k) plan account balance, it is important to understand that fees and expenses may substantially reduce the growth of your 401(k) plan account balance over the course of your working life. The Department of Labor (DOL) estimates that paying 1% in extraneous fees can reduce your 401(k) plan account balance by 28% over the course of 35 years.

Accordingly, it is important to familiarize yourself with the various types of fees and expenses that can affect the growth of your 401(k) plan account balance. This fact sheet summarizes many of these common fees.

Plan Administration Fees

Administrative fees are incurred in the day-to-day operation of the 401(k) plan for services such as recordkeeping, accounting, legal and trustee services. Recordkeeping services may include access to customer service representatives, telephone or internet response systems, investment education or advice, on-line transactions, and a website to access plan account information.

Plans pay administrative fees in different ways. Some investment fund companies rebate a portion of their revenue back to the 401(k) plan (or the 401(k) plan's record keeper), and those rebates are then used to pay administrative fees and expenses. This process is commonly known as "revenue sharing." Alternately, administrative fees may be separately charged to the 401(k) plan to the extent the employer does not voluntarily pay them. If administrative fees are paid by the 401(k) plan, they are allocated to participants' accounts as either a flat fee (for example, $20 per calendar quarter) or in proportion to participants' individual account balances (for example, participants with larger account balances pay proportionately larger fees).

Individual Service Fees

A 401(k) plan might charge fees only to participants who take advantage of certain services. Examples of these individual service fees include fees associated with taking a loan, in-service withdrawal or distribution from the plan, processing a qualified domestic relations order (QDRO), or executing your investment directions.

Investment Fees

Generally, the largest fees incurred by a 401(k) plan relate to the investment of plan assets. Examples of these fees include:

- *Sales Charges* – Also called loads or commissions, these charges are transaction costs; the 401(k) plan incurs these charges when it buys or sells investments. Sales charges may be either charged at the time the investment is made ("front-end loads") or when the investment is sold ("back-end loads").

- *Management Fees* – The investment management fee covers the ongoing cost of research and the professional management of the underlying investments in each fund. Management fees and other operating, administrative, and 12b-1 (promotional and marketing) expenses are paid directly out of each fund's assets. Together, these fees and expenses equal what is known as the expense ratio and are factored into the quoted share price and returns for a particular fund. The fund's expense ratio lowers its net rate of return.

  Management fees vary based on the level of management required for the particular investment product. An "actively managed" investment fund (*i.e.,* a fund with an investment manager who actively trades the fund's holdings to seek a higher return than the market) is generally more expensive than a "passively managed" investment fund (*i.e.,* a fund that duplicates the holdings of an established market index, such as the Standard and Poor 500). In addition, "retail" share classes, which are marketed to small plans, tend to charge higher fees than "institutional" share classes, which may be available to large plans.

  As noted above, management fees may be used to pay administrative fees.

Common Investments and Related Fees

- *Mutual Funds* – A mutual fund pools money collected from many investors for the purposes of investing in stocks, bonds, and similar assets. Each investor owns shares in the mutual fund, which is managed by an investment professional according to a specific investment policy. Mutual funds may assess sales charges and management (12b-1) fees.

  Many 401(k) plans use target-date retirement funds as their qualified default investment alternative. These funds are designed to change their investment allocation over time to become more conservative as participants approach the target retirement date. If the target-date retirement fund invests in other mutual funds (commonly known as a "fund-of-funds"), both the target-date retirement fund *and* the underlying funds in which the target-date retirement fund invests may charge fees and expenses.

- *Collective Investment Funds* – A collective investment fund is managed by a bank or trust company that pools investments of multiple 401(k) plans together. Each investor has a proportionate interest in the trust fund assets. A collective investment fund may charge investment management and administrative fees.

- *Variable Annuity* – A variable annuity contract is offered by an insurance company. The variable annuity contract "wraps" around the 401(k) plan's investment options (such as mutual funds) and generally includes one or more insurance elements (such as annuity features, interest and expense guarantees, and death benefits). In addition to management fees and administrative fees, variable annuity contract investment may trigger insurance-related fees, including sales expenses, mortality risk charges, and the costs of issuing and administering such contracts. In addition, if the employer were to terminate an insurance contract before the term of the contract expires, surrender and transfer changes could apply.

- *Stable Value Funds* – A stable value fund invests primarily in fixed income securities (such as highly-rated bonds and cash equivalents). These investments are "wrapped" with insurance contracts to guarantee a specific minimum return. Investment management and administrative fees may apply to stable value fund investments.

How to Obtain Fee-Related Information

If you direct the investment of your 401(k) plan account balance, the plan administrator is required to provide you with information about the plan and the investment alternatives available under the plan, including fees and expenses, to help you make informed decisions with respect to your 401(k) plan account balance. You should receive this information before you make an investment election and then at least annually thereafter. In addition, your 401(k) plan's summary plan description describes important features of the plan and may include a description of certain fees. If you have questions about the fees applicable to your 401(k) plan, contact your plan administrator.

The DOL has also published a fee summary, "A Look at 401(k) Plan Fees," to help plan participants understand how fees affect their retirement savings: http://www.dol.gov/ebsa/publications/401k_employee.html.

Do you have any questions about this fact sheet? Call the Pension Action Center at 888-425-6067 or visit us online at pension.umb.edu

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