In Praise Of Fee Disclosure

By Ary Rosenbaum, Esq.

People who didn't sponsor a plan or weren't involved in the retirement plan industry before 2012, think some 401(k) industry veterans like myself, are part of some multiverse when we talk about life before fee disclosure. The fee disclosure regulations implemented by the Department of Labor (DOL) in 2012 was a game changer in the retirement plan industry. The big winners were plan participants who played less in fees, plan providers who believed in fee transparency, and plan sponsors who could exercise their fiduciary duty to pay only reasonable plan expenses. The losers were the chicken littles who predicted gloom and doom and plan providers who didn't want plan sponsors to know how much their plan was being charged.

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The good old days weren't that good

It was a weird dichotomy in the retirement plan space when a plan sponsor had a fiduciary duty to pay only reasonable plan expenses. Still, the plan provider didn't have to tell the plan sponsor how much they were charging. It was a fee shell game where a plan provider might have a 401(k) plan sponsor who thinks they're paying one direct fee but neglects to tell them about the indirect fees they were pocketing. This was mainly happening on the third-party administrator (TPA) side. They may have been receiving revenue-sharing payments and sub ta fees from mutual fund companies that wanted their funds to be featured on 401(k) fund lineups. The problem is that many TPAs didn't disclose these payments and only actively managed mutual funds could afford to make these payments to the TPA for plan administration. An index fund that has a single-digit basis point expense ratio can't muster a revenue-sharing payment to a TPA. So plan providers would claim that index mutual funds would be more expensive to administer, neglecting to factor in the increased cost of expenses of actively managed funds that paid revenue sharing. It truly was a shell game and I can't forget the one TPA that would tell their clients they were slashing their fees by switching platforms with the same custodian, but neglected to tell them they were pocketing extra fees through revenue sharing. Many brokers wouldn't mention they were getting compensation through mutual fund 12b1 fees, which might explain why they always pushed actively managed funds that could afford to pay these fees. Direct expenses weren't the issue, the indirect expenses that plan providers were getting were never fully disclosed.

The chicken littles and the industry that fought it

Back in 2010, people like me, a good friend, James Holland, and a small bunch of plan providers were outliers in the industry because we stressed the need for fee transparency. The now-retired spokesman of one of the main 401(k) trade groups criticized providers like me for calling for fee transparency because it made the industry look bad. What looked bad was an industry that felt it needed to hide the

fees it charged when the main clients, plan sponsors, had the duty to know the fees that were being charged and they had to be reasonable. Wall Street threw enough money at Congress that any Congressional attempt at fee disclosure was futile. It took President Obama appointed DOL Employee Benefit Security Administration (EBSA) head Phyllis Borzi to have the DOL roll-out fee disclosure regulations. Some of the industry became chicken littles with false claims that plan sponsors would terminate their 401(k) plans if they had to deal with the burden of evaluating fee disclosures. Needless to say, the mass terminations of 401(k) plans never happened and the only mass exodus was large insurance-based providers who exited the business by selling their 401(k) TPA and custodial businesses to their competitors. The Chicken Littles also made wild allegations that fee disclosures would cause a race to zero in administrative fees and only the cheapest plan providers would benefit. Again, plan sponsors exercised their duty to pay reasonable plan expenses, they understood that it didn't mean the cheapest plan expenses. Plan providers that were no frills and cheap, didn't become industry heavyweights, I assure you. I always say that if you have nothing to hide, then being transparent shouldn't be an issue. So when the stock market tanks again, the media won't have to focus on hidden 401(k) fees.

The benefits of fee disclosure

For the most part, fee disclosures helped the industry. In the old days, anytime the stock market went south, there would be reporting on high, non-transparent 401(k) fees and the alphabet soup of shares classes that had charges and hidden fees. I worked for a producing TPA (that means it had its own advisory business) and I will assure you, that there were many presents from mutual fund company representatives at Christmas time for the advisors who were picking the funds for their clients' fund lineups. Fee transparency was about divulging information, especially to plan sponsors who had that duty to only pay reasonable plan expenses. As a result, retirement plan administrations have seen fee compressions. As a percentage of assets, fees have been lowered, almost every year since 2012. Since participants usually paid the freight of 401(k) administration (don't get me started on that), that's more money in their pockets. Participants pay less in mutual fund expenses because the cut in the use of revenue-sharing funds in 401(k) fund lineups has allowed for lower-cost index funds. Transparency spurs competition and competition and technological improvements have helped lower 401(k) fees. Transparency also helps by giving participants notice too, of the fees that they're paying in a daily valued, participant-directed environment. As a plan sponsor that is having participants pay the fee, there is nothing better than to fully disclose the fees they're paying for this important employee benefit.

It's not a perfect system

The DOL fee disclosure regulations aren't perfect. With some plan providers, you need a forensic accountant and an ERISA attorney to decipher some plan provider fee disclosures. What I feel was the DOL's biggest mistake is not creating some sort of uniform fee disclosure forms just like the Food and Drug Administration has set requirements on nutritional and caloric value for food products that are uniform and easy to understand. Fee disclosures should be no different than the invoice sticker on a new car, and fit on one page in easy-to-understand language that participants could understand. In addition, fee disclosures are mum and not required one of the biggest potential abuses in fees, is the deconversion fee that a TPA may charge after being fired by a plan sponsor. Firing a TPA is business, not personal. Yet from experience, some TPAs feel it's personal and charge exorbitant deconversion fees to punish the plan sponsor client that fired them. Another drawback of fee disclosure is that while it's mandated, so many plan sponsors from small and medium-sized businesses don't bother to check their fee disclosures for the actual cost, as well as not benchmark them to see if they're reasonable. Of course, fee disclosures for participants have made it easier for plans to be sued, but the Federal courts are getting tired of these cases and mere overpayment alone isn't necessarily a fiduciary breach. No change in any business is perfect or lacks any drawbacks.

The Rosenbaum Law Firm P.C.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw