

Fee Transparency and Investment Neutrality in Retirement Plans

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Insights from an industry leader

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Securian Retirement, a unit of Minnesota Life Insurance Company, offers a full range of retirement products and services to individuals, plan sponsors and advisors. The information presented here refers specifically to our 401(k) and other qualified retirement plan programs. All of our retirement plan products are offered through a group variable annuity contract issued by Minnesota Life.

Summary

Retirement plan sponsors have important fiduciary responsibilities to plan participants. Understanding plan expenses and determining if they are reasonable are among the most important.

For plan sponsors, it's critical that expenses are transparent (i.e., well-disclosed and easy to understand) and prudently applied to participants. Emphasis must be on minimizing or eliminating potential conflicts of interest and allocating expenses fairly.

Historically, some fee structures have lacked clarity, adequate disclosure, or both. These structures frequently favor one or a group of investment options, and create often hidden incentives to drive plan assets into these options, regardless of investment merit.

Recently, regulators have begun to take steps to help plan sponsors with their fiduciary duties by requiring more extensive and easier-to-understand fee disclosure. While these regulatory changes should certainly help plan sponsors, this paper asserts that plan sponsors and participants are best served by:

- Clear, understandable and fully disclosed plan fees; and
- Fee structures that do not favor a particular investment or set of investments.

Fee transparency is not new or expedient to Securian retirement plans. It has been the backbone of our practice since we entered the retirement plan business. In short, we believe that unless fees are transparent, clearly understood and fair, plan sponsors are exposed to fiduciary risks.

Fee transparency and investment-neutral pricing have been hallmarks of Securian retirement plans since we started offering non-proprietary funds in 1993 – well before federal agencies began regulating fee disclosure.

Securian follows a full and open disclosure approach in which all plan fees are clearly outlined.

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Introduction

Fiduciary Responsibilities Regarding Fees

The Employee Retirement Income Security Act of 1974 (“ERISA”) spells out key fiduciary duties for pension plan sponsors, including:

- Understanding the **total costs** of sponsoring a retirement plan and periodically evaluating plan expenses; and
- Ensuring that expenses are “reasonable” for the services received.

A majority of plan service providers, and many advisors, receive indirect payments from retirement plan investments. These payments from mutual funds are typically either marketing (“12b-1”) or administrative (“sub-TA”) fees. This is referred to as “revenue sharing.” There’s nothing inherently wrong with these payments, but it’s vitally important that fiduciaries understand how they are applied and disclosed.

In the past, many in the industry have either been reluctant to disclose revenue sharing, or have made disclosures difficult to find and compare. If these revenues are retained by the provider, but not clearly disclosed, other plan fees can appear lower and more favorable to the plan sponsor than they really are. Because many fiduciaries cannot easily identify the total cost of the service, the task of assessing these costs is much more difficult.

The Department of Labor has taken the position that fiduciaries who fail to know about and evaluate indirect payments are breaching their fiduciary responsibilities. Fiduciary responsibilities include evaluating whether the total amounts received are reasonable, and whether payments cause potential conflicts of interest. Clearly, if potential conflicts exist, and if some participants inappropriately pay more fees than others, plan sponsors may be exposed to increased fiduciary risks.

The Two Keys to a Fiduciary-Friendly Fee Structure

Fee transparency and investment-neutral pricing are critical to plan fiduciaries seeking to understand and assess the reasonableness of plan fees and reduce and/or eliminate conflicts of interest.

Fee Transparency

Generally speaking, retirement plans incur both explicit (i.e., annual plan, participant, and activity-based) and implicit fees (i.e., those embedded in some way and ultimately reflected in investment returns). Explicit fees are typically clear in their description and disclosure and are usually not confusing or misunderstood.

That’s not always the case with implicit fees. Implicit fees can include investment management, 12b-1, and sub-TA fees, along with other investment operating expenses and charges for plan administration, advisor services and advisor compensation. Plan providers may also receive tax benefits from foreign tax credits. No matter the source, all of these revenues should be disclosed.

A common industry practice has been to use certain investment-related revenues (12b-1, sub-TA, and foreign tax credits) to offset some of the other plan costs (plan administration/recordkeeping, advisor compensation). Frequently, with this approach, the description and disclosure of fees are missing entirely or shown in several different places. This makes it difficult, if not impossible, to evaluate the total costs. (Your Securian representative can provide more detail and examples of these practices.)

A better practice, (one that Securian has consistently used) is to disclose each of these costs in one place, displaying the total implicit cost associated with each investment option ... it simplifies clear comparison across providers and allows a fair and open assessment of the appropriateness of the fees.

A better practice (one that Securian has consistently used) is to disclose each of these costs in one place, displaying the total implicit cost associated with each investment option. This is critical for creating a fiduciary-friendly pricing structure. It simplifies clear comparison across providers and allows a fair and open assessment of the appropriateness of the fees. Beyond helping plan sponsors meet their fiduciary responsibilities, it's simply the right thing to do.

As fiduciaries learn to appreciate the importance of understanding fee structures, and as the regulatory framework requires increased disclosure, we expect to see provider disclosure practices improve. They may eventually mirror the best practices already used by some. Yet, even better disclosure won't fully address the potential conflicts that occur when a provider favors one investment option over another.

Investment-Neutral Pricing

The potential for conflicts of interest in the financial operation of the plan pose pitfalls for any plan fiduciary. That's why ERISA generally prohibits transactions between parties in interest.

While not all potential conflicts materialize into actual problems, it's critical to understand where conflicts may arise. With a plan's investment options, the plan sponsor must determine whether the fees are reasonable and prudently applied to participants.

Historically, common practice required the use of one or more proprietary investment options. There may be any number of reasons for requiring proprietary products, but the most logical (and prevalent) reason is the generation of higher revenue for a provider. Over time, competition has diminished this practice, and fund platforms have opened to more non-proprietary managers. But the practice has not vanished entirely.

Other common practices are to either require specific funds and/or share classes of funds in a particular plan or to reduce more visible fees, such as plan administration and recordkeeping fees, based on the funds chosen. Such practice, however, does not generally reduce the total cost for the plan. These are common in the retirement plan market, as fund revenue (12b-1, sub-TA, etc.) has become a critical piece of the revenue puzzle for many providers. Because these fund revenues are often misunderstood or overlooked entirely by plan sponsors, they can be used to offset more visible fees, like those for plan administration and recordkeeping – making those fees *appear* lower.

It's also common to promote and/or aggressively market certain investment options within a plan. By encouraging the use of higher-revenue investment products, it's possible to reduce the apparent costs to the plan while maintaining or enhancing the provider's total revenue stream. This practice is especially common with respect to lifestyle and/or lifecycle "funds of funds." These investments frequently carry an additional level of expense beyond that of the underlying funds, and are frequently used as QDIA "default" solutions for a large number of plan participants. Managed accounts are also revenue rich solutions that are often proposed for use as default strategies.

In each of these cases, the fiduciary is often in a more vulnerable position because the true costs of the plan are not well understood. Also, these sources of revenue are often used to reduce the illustrated fees, but not necessarily the *actual* expenses. This can create an incentive to maximize these revenues – even if that means using an inferior investment manager or fund share class.

Of course, plan sponsors should always seek to understand the total costs associated with the plan. This is especially critical when plans are encouraged to choose particular investment solutions and/or "map" plan assets to these investments.

Investment-neutral pricing is a far better practice. With this approach, the provider receives revenue fairly and equally across all of the plan’s investment options. The provider using investment-neutral pricing has no incentive to require the use of any particular investment option, or to promote the use of one investment over another for revenue-related reasons. An investment-neutral provider is free to seek the best available investment product at the lowest total cost. As a result, the provider’s interests align clearly with those of the plan sponsor/fiduciary.

Investment-Neutral Pricing is characterized by:

- **No proprietary fund requirements** – including no mandate to use fixed return general account and/or stable value products.
- **No difference in explicit or implicit provider fees** resulting from the investments chosen.
- **The return of all mutual fund revenue-sharing amounts** (12b-1 fees, sub-TA fees, etc) to the plans and participants investing in that fund.
 - If all revenue is passed back, the particular share class chosen is not important. What matters is the net cost (total fund cost less revenue sharing). As a result, plans may have a mix of funds ranging from high (gross) cost advisor shares to low-gross cost institutional shares.
- **Direct application of any foreign tax credit revenue** created by an investment option. This also reduces costs to the plans and participants investing in that option.
- **Equal advisor compensation across each of the plan’s investment options.** When an advisor is involved, this “levelized” compensation helps ensure that the advisor has no conflict of interest in the plan’s investment selection process.
- **Clearly articulated investment management and investment operating expenses.** Different investment structures may carry different costs. For subadvised options, for example, the total cost will often involve the subadvisor’s management fees as well as small additional costs for accounting, custody, or other administrative functions. In any case, the sources and levels of the costs should be clear.

The retirement plan market supports many different investment structures (mutual funds, insurance company separate accounts, commingled trusts, sub-advisory arrangements, etc). Fortunately, an investment-neutral approach can work with any of them.

In all cases, it’s critical to be sure that the provider’s fees don’t change based on the investments chosen. If the fees do vary, it’s a sign that the plan fiduciary should take a closer look.

Remaining completely revenue-neutral and fund-selection neutral allows funds to be selected on merit, not on the amount of revenue sharing provided. Full, transparent disclosure of expenses is fundamental to the fiduciary needs of plan sponsors.

Note that expenses are less relevant and often not clearly identifiable for fixed return products (i.e., stable value or insurance company general account options). For insurance company general accounts, for example, all assets are comingled, so there’s no identifiable “expense spread.” Instead, the critical factors in assessing these options are:

- The net interest rate earned on the investment option
- The strength of the guarantee (i.e. the financial strength of the issuer)
- The absence of any requirement to use the fixed-return option (or any apparent “price reduction” for choosing this option). If the pricing changes based on the use or non-use of the general account, the plan sponsor should be concerned about the plan provider’s practices.

In all cases, it’s critical to be sure that the provider’s fees don’t change based on the investments chosen. If the fees do vary, it’s a sign that the plan fiduciary should take a closer look.

Investment-neutral providers seek to provide the best available investment product at the lowest total price. As a result, the provider's interests align clearly with those of the plan sponsor/fiduciary.

To learn how fee transparency and investment neutrality can benefit you, call 1-877-876-4015 or contact your Securian representative.

Conclusion

While recent regulatory changes have begun to encourage others in the industry to enhance their processes and become more transparent and fair, Securian has been doing this all along.

Securian's investment-neutral approach has been in place since we began offering non-proprietary investment options in 1993 and has always been applied to all clients – past, present and future – regardless of the size of the plan or the product chosen. It has allowed Securian's plan sponsors, and any advisor the sponsor may use, to make investment option decisions based on transparent disclosure of related fees.

Building on our mutual company heritage, we are particularly vigilant on aligning our interests with those of our plan sponsors and participants. Our long-standing reputation for transparency and fee disclosure has served our clients well. Ultimately, we believe that doing the right thing is good business, and best serves our mission of providing financial security for the long run.

About Securian Financial Group, Inc.

With origins to 1880, Securian Financial Group is one of America's largest providers of financial security for individuals and businesses in the form of insurance, investments and retirement plans. It is the holding company parent of a group of companies that provide a broad range of financial services including Minnesota Life Insurance Company.

Headquartered in St. Paul, Securian's financial strength and claims-paying ability ranks it among the most highly rated insurance company groups in the nation. For more information about the rating agencies and to see where Securian's rating ranks relative to other ratings, please visit securian.com/financials.



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