Fee Disclosure

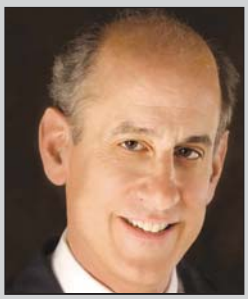
The DOL's Revenue Ruling Is Much Ado About Nothing

By CHARLIE EPSTEIN, ChFC, AIF

Much is being written about participant fee disclosure, the Department of Labor's 404(a)(5) revenue ruling, which was implemented on Aug. 30. The new fee disclosure for retirement-plan participants went into effect, meaning that most previously hidden fees will now be disclosed to the employees who participate in their companies' 401(k) plans or other plans.

Let's get to the real facts: some fees will continue to stay hidden. Many carriers are already rushing to circumvent the DOL's disclosure requirement for participants' 401(k) plans by continuing to bury them in the plan's mutual-funds expense ratio. They will do this by creating new mutual fund share classes.

There are three levels of potential fees that participants may pay when they are enrolled in 401(k) plans:



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• **Fund-expense ratios.** This is the amount deducted on a daily basis from each mutual fund to pay for the 12b-1 fees, commissions, advertising, and the money manager. (Note: not all funds pay 12b-1 funds, such as index of ETFs.) There is a real misnomer here regarding disclosure and transparency to participants. The truth is that the majority of participants will still not know or understand what they are paying for with this expense because it will not appear on their quarterly statements.

The expense ratio, which is declared in basis points as a percentage (such as three-fourths of a percent), will remain buried in the fund. On top of this, it will now be hidden in a pile of disclosure papers, which 401(k) record keepers must provide on an annual basis to each participant. The expense ratio for each fund will appear in this disclosure report with a per-$1,000 conversion rate per $10.

Confused yet? Of course you are, and participants will be, too. Most 401(k) plan participants (85%) don't know and don't want to know about any of this, and these 16- to 25-page annual reports will end up in file 13.

Have you refinanced your home mortgage lately? Thanks to Dodd/Frank, consumers receive 10 times the amount of 'disclosure information' they did prior to the 2008 credit crisis. Who do you think is really reading any of that information? Once again, big-government and bigger-bureaucracy do-good thinkers failed to understand a basic principle of investing: the majority of 401(k) participants don't read the information they have now. The real proof: the majority of this information has been readily available on participant websites for years, and employees still don't read it.

• **Asset charges and wrap fees.** Some 401(k) plans may charge an additional asset fee or wrap fee to cover the record-keeping expenses or fees and commissions to the plan's advisor. If your 401(k) plan has this expense, you have not been aware of it, and it will appear for the first time starting this month. The 401(k) record keepers must convert this expense into a dollar amount and show it subtracted from the participant's account each quarter.

Many in the press have stated that millions of participants will take to the streets when they see this hidden cost suddenly appear on their statements for the first time. I say it will be much ado about nothing. Yes, some (the minority) will read it and respond, 'what is this?' and go racing to their HR departments, in revolutionary mode, demanding answers. They will be told, 'there is no free lunch, and you have been paying this; you just didn't know!' The vast majority will either not even notice it, notice it and not care, or notice it and realize, 'wow, just as I thought. I have been paying something for my 401(k). I just didn't know what, and now I do.'

I have been managing 401(k) plans for three decades. Years ago, a handful of the carriers we worked with started disclosing fees. Of all the plans we managed that began disclosing fees on their quarterly statement — did the employees react negatively? Once we met with them and showed them they had always been paying fees and that they just didn't see the fee on their statements, the majority smiled and joined the 'yes, Toto, we are not in Kansas anymore, and there is no free lunch' club. That was six years ago, and no one has complained since.

Just last week, I had a meeting with the CFO of a company whose plan we had changed to a new 401(k) provider a year ago. The new provider has been reporting all fees as a dollar amount deducted from participant accounts on a quarterly basis for four quarters. When I asked the CFO if anyone has questioned this amount, he responded (rather embarrassed), "no one has said a peep, and, to tell you the truth, I didn't even notice it on my statement." This is the company CFO. He's the guy responsible for watching every penny the company spends, and he didn't even notice what he was spending on his own retirement account.

• **Participant fees.** These fees are usually charged directly to a plan participant to cover the cost of receiving a 'paper' quarterly statement, perhaps $1.25 per quarter, or to take out a loan, maybe a $100 flat fee.

The bottom line here is everyone knows there is no free lunch, even in a 401(k) plan. What matters most is what participants do with this information and what advisors can do to support greater participant success.

The 401(k) represents one of the best mechanisms for the average working American to save and invest for a secure future. The fact that some participants may be surprised that this system has a cost pales when compared to the surprise these same individuals will have if their future living expenses cost more than their 'paychecks for life' can handle. ■

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