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Plan Sponsor's Guide to Retirement Plan Fees

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A guide to retirement plan fees

Today's plan sponsors face the challenge of providing plan governance in an increasingly complex marketplace. For example, there are now more than 8,000 investment companies offering over 15,000 funds.¹ In addition, government regulations that interpret plan-related legislation are continually being refined and updated.

Recently the public spotlight has turned to retirement plan fees. Plan sponsors are being reminded of their fiduciary responsibility to accurately determine and evaluate their plan fees. Because of the multiple providers involved and the various ways fees are assessed, it can sometimes be difficult to determine who is receiving how much, and for which services. Yet that information is necessary to determine if plan costs are fair and reasonable.

This guide will provide you with information about retirement plan services and fees to help you more accurately calculate your plan costs and determine whether they are a good value for you and your participants.

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¹ Investment Company Institute (ICI) 2006 "Fact Book."

Reviewing fiduciary responsibility

Plan sponsors know that they have a legal obligation, as defined by the Employee Retirement Income Security Act (ERISA), to make decisions that are in the best interests of their participants. They are considered plan fiduciaries and as such assume corporate and personal responsibility for the decisions they make. These decisions always require ongoing oversight and review and may include appointing an investment committee, choosing plan providers and selecting investment options.

In addition to the fiduciary responsibilities specifically outlined in ERISA,² recent court decisions strongly suggest that plan sponsors also have some responsibility to help participants save enough for retirement. As a result, plan sponsors are assuming an increasingly active role in encouraging employees to enroll in their plans, and helping them choose adequate deferral levels and appropriate investment options.

This is where plan costs become a critical component. Expenses associated with legal counsel, investment consultants, recordkeepers, fund offerings, trustees, auditors, and other paid providers are usually considered plan costs. These costs, in turn, have an impact on bottom-line returns for participants and can ultimately affect the amount of money participants accumulate for retirement.

Plan sponsors have a fiduciary obligation to know the total costs of operating a plan. Although they are not required to choose the least expensive services, they do need to know who is receiving money — how much and for what services — and whether these costs represent reasonable pricing and provide good value.

Selecting the appropriate service provider(s) does not equate to choosing the least expensive option. In fact, the U.S. Department of Labor provides the following guidance: 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.³

² Plans that are not subject to ERISA can also benefit from a thorough fee review.

³ U.S. Department of Labor online publication, “A Look at 401(k) Plan Fees.”

Bundled/Alliance providers

Some providers offer plan services bundled together in one-stop-shopping packages. These services include investment, recordkeeping, administration and education services. Many bundled service providers can offer the entire range of administrative services such as Form 5500 preparation, plan documents and amendments, participant refunds when contribution limits are surpassed, trustee services and more. To increase investment flexibility they may create alliances with investment management. In some cases plan sponsors may desire additional services, such as independent investment advice, legal counsel, and in-house administrative staff. Costs for offering a bundled/alliance plan are generally lower than an unbundled offering.

Unbundled providers

Unbundled providers including Third Party Administrators (TPAs) allow plan sponsors to pick and choose among a variety of vendors for recordkeeper, custodian, education provider and more. Other administrative services such as testing, plan document reviews, investment consulting and advice are billed separately. In this case the plan sponsor is providing the bundling service and may require additional internal staff to manage the plan. As with any highly tailored approach, fees for unbundled plans are often higher than a bundled approach.

On the next page is a summary chart of typical plan fees. Notice the investment option fees, which are paid by participants. It would be easy to overlook these plan costs because the returns that are reported and passed on to participants are *net of fees*. Likewise, costs such as annual audits and compliance services, because they are cyclical or intermittent, can be easily missed when calculating plan costs. Expenses associated with the salaries, benefits, and overhead of dedicated in-house staff should also be factored into overall plan costs.

Returns net of fees

The investment return reported to participants is usually net of fees, which means its rate of return is reduced by its investment management fees.

Example fund

Return on assets =	8%
Management fees =	(1%)
Return net of fees =	7%

One-time fees	Ongoing fees		
<p>Plan setup, conversion and miscellaneous fees</p> <p>Paid by plan sponsor</p>	<p>Plan administration⁴</p> <p>Paid by plan sponsor or may be passed on to participants</p>	<p>Investment options</p> <p>Paid by participant as a percentage of total assets</p>	<p>Participant fees</p> <p>Often paid by participant, sometimes paid by plan sponsor</p>
<p>Plan setup</p> <p>Fees charged by provider for setting up a new plan, including installation fee, education program, enrollment expenses</p> <p>Plan conversion</p> <p>Fees charged for converting a plan from one provider to another — in addition to setup fees, includes contract and service termination charges</p> <p>Changes in plan services</p> <p>Fees associated with the addition or termination of services (for example, adding or removing an investment option; adding online advice; adding a brokerage window)</p>	<p>Administration/Recordkeeping</p> <p>Costs associated with keeping a record of participant accounts</p> <p>Custodial/Trustee services</p> <p>Costs associated with safekeeping plan assets</p> <p>Enhanced service platform</p> <p>Expenses related to enhanced participant services such as brokerage or mutual fund windows, communication and education programs, online advice, etc.</p>	<p>Expense ratio</p> <p>Fees associated with managing a mutual fund, including investment management, operations, administration and marketing</p> <p>12(b)-1 fees</p> <p>Fees included as part of a mutual fund's expense ratio — used to pay for sales commissions, account servicing and sometimes to offset the cost of other plan services</p> <p>Front/Back-end loads</p> <p>Fees assessed when a fund is purchased (front-end load) or at the time of sale (back-end load) — back-end loads are typically reduced or eliminated after a given period of time</p>	<p>Redemption fees</p> <p>Fees charged when a fund is sold before a stated minimum holding period has elapsed</p> <p>Brokerage/mutual fund window fees</p> <p>Annual and/or individual transaction fees charged for the use of a brokerage or mutual fund window</p> <p>Advice-related fees</p> <p>Annual and/or usage fees associated with online, one-on-one or other advice platforms</p>
<p>The Committee on Investment of Employee Benefit Assets (CIEBA) recommends disclosing the fees and costs charged to each participant.</p>	<p>Investment consulting</p> <p>Expenses associated with independent advice regarding investments and/or plan structure</p> <p>Intermittent/Cyclical services</p> <p>Costs periodically incurred for legal counsel, audits, participant education, compliance services, company stock administration, etc.</p>	<p>Privately managed/collective fund fees</p> <p>Similar to mutual fund fees — may be referred to as investment management fee</p> <p>Wrap fee</p> <p>Fee associated with managing a variable annuity, including investment management, operations, administration and marketing — may include an insurance benefit feature, front and/or back-end loads and redemption fees</p>	<p>Company stock fund fees</p> <p>Fees charged for buying and selling shares of company stock</p> <p>Other fees</p> <p>Distribution fee — A fee charged to withdraw participant assets from the plan</p> <p>Loans — Service fees on participant loans</p> <p>QDRO — Service fees associated with a Qualified Domestic Relations Order</p>

⁴ Fees can be charged as a percentage of assets and/or on a per-participant basis, or based on other criteria.

How plan fees are structured

The types and levels of fee assessment differ among and within plans depending on a number of circumstances, including: asset base, number and location of participants, types of investment funds permitted, sophistication of the service platform, education and/or advice services offered.

Fees can be classified in the following three ways:

Itemized	Participant-based	Asset-based
This fee is a charge for a specific service.	This fee is imposed on a per participant basis (can be itemized).	These fees are a percentage of the total assets of your plan.

Have the assets in your plan grown substantially over the past few years?

Are you paying the same asset-based fee you were originally charged when your plan was new?

Ask your provider if your fee structure is still appropriate for the asset base and number of participants in your plan.

Although the number of variables involved make it difficult to define an average plan or estimate its costs accurately, it is possible to estimate the fees and expenses any plan is likely to incur.

For example, let's assume that you are ABC Corporation, with 500 employees and an asset base of \$6 million. You're terminating your current services and transferring to a bundled provider. You *could* expect to pay:

Itemized fees

- One-time setup fee with your new provider
- Termination/redemption charges with your current providers

Participant-based fees

- Annual per-participant fee, and/or

Asset-based fees

- Asset-based fee for recordkeeping, custodial and other services
- The costs associated with your investment option lineup will be paid by participants through expense ratios and other fund fees

Understanding basis points

What is a basis point (bp)?

Financial professionals often use the term *basis points* for numbers less than 1 percent.

1 basis point = 1/100 of a percentage point

Example 1: 1 bp = 0.01% or 0.0001

Example 2: 30 bps = 0.30% or 0.0030

Example calculation

Assume a plan provider charges 30 bps annually on the total amount of assets in your plan.

\$ 6,000,000 in plan assets
 $\times 0.003$ (30 bps = 30/100% or 0.003)
 = \$18,000 fee

Locating hard-to-find fees

The “free” myth

Some providers promote their products and services with the claim that they charge no fees for a portion or all of their services. The implication is that these services are free. Common sense indicates otherwise. Obviously it costs money for providers to make their services available, and it would be impossible for them to maintain their businesses without adequate compensation, including some level of profit.

Providers who offer “free” services are typically compensated through fees that are imbedded in their products, rebates from other plan providers and/or the expectation of future revenue. For example, the costs of setting up a plan may be absorbed by a provider in anticipation of the income stream generated through annual asset-based or per-participant charges. This is particularly true of a plan with a substantial asset base. Likewise, a mutual fund company acting as a bundled provider may offer “free” recordkeeping services. In this case the recordkeeper is typically compensated through rebates from mutual fund fees.

Plan sponsors who understand these fee structure dynamics are better equipped to know what questions to ask their providers and perhaps even to negotiate more favorable terms for their plans.

Common hard-to-find fees

Revenue sharing also presents a challenge for the plan sponsor when it comes to calculating plan costs. That’s because revenue sharing fees are often embedded in other fees, making it difficult to determine payment schedules.

12(b)-1 fees

The expense ratio of a mutual fund pays for the costs of asset management, administration and operation, and sales and marketing. The portion of the expense ratio that covers account servicing and sales costs are referred to as 12(b)-1 fees. These fees can be used as sales commissions to compensate brokers. Mutual fund companies are also permitted to assign a portion of their 12(b)-1 fees to other plan service providers, such as recordkeepers. Not all funds charge 12(b)-1 fees.

Sub-transfer agency (sub-t/a) fees

Trust companies, banks, and mutual fund companies, acting in the capacity of fund transfer agents, frequently subcontract with other entities to track buy and sell orders and credit them to the appropriate participant accounts. These sub-transfer agents are compensated by investment fund companies through revenue sharing sub-t/a fees.

Understanding share classes

Investment funds come in a variety of share classes. These funds have the same underlying investments, but their fees vary depending on their share class designation. Some share classes include front and/or back-end loads. Others have higher expense ratios than others.

Potential conflicts of interest

Investment fund companies are permitted to rebate some of their fees to plan service providers through revenue sharing. As long as the recipient of the money is not a fiduciary, it is entirely permissible to underwrite other plan services this way. In fact, revenue sharing can help offset plan costs.

For example, many fund companies contract the job of tracking individual account activity to recordkeepers. Fund companies compensate recordkeepers for these services through revenue sharing.

There is the possibility, however, that revenue sharing can lead to conflicts of interest, which in turn could potentially compromise the investment option lineup and/or result in increased fees.

Consider, for example, what can happen when providers assist plan sponsors in choosing investment lineups for their plans. Let's say that Provider A is a bundled provider for the Smith Corporation Retirement Savings Plan.⁵ The investment committee needs assistance putting together a diversified investment lineup. The broker, who will be compensated through revenue sharing, may now be facing a conflict of interest — and Smith Corporation is likely unaware of the dilemma.

What if the broker had to choose between offering a mediocre fund with a high expense ratio (resulting in a high commission) and an excellent fund with a modest expense ratio? Now not only are fees an issue, but investment quality as well. As a fiduciary, the plan sponsor is required to make decisions based solely on the best interests of its participants. However, in a case such as this, the plan sponsor may not even be aware that fiduciary standards are in danger of being violated.

The outcome in these and other similar situations will likely depend upon the integrity of the broker and the due diligence of the investment committee. As with all other aspects of plan design and supervision, it pays for plan sponsors to be informed consumers.

⁵ This example is hypothetical and for illustrative purposes only.

Practice questions

Questions to ask your consultant, third party administrator, mutual fund company, investment advisor and/or broker⁶

- Q. Do you or any other entity receive sub-transfer agent revenue?
 - If yes, is this revenue offset directly against stated costs as described in a service agreement?
- Q. Are you operating under a suitability or a fiduciary standard? In other words, are you a non-fiduciary registered representative or are you a fiduciary registered investment advisor?
- Q. If you are a registered representative, are you receiving revenue sharing from fund companies?
 - If yes, what is the annual value of the revenue you receive?
- Q. What is the total expense deducted from participant accounts in our plan? Please provide the total expense of each fund offered in our plan.

Looking for more information?

Publications available from The Standard

- “Plan Sponsors’ Guide to ERISA 404(c)”
- “Protecting Participants: Understanding Your Role as a Fiduciary”

Resources for plan sponsors

- “Uncovering and Understanding Hidden Fees”:
http://www.401khelpcenter.com/pdf/mdh_understanding_fees_v2.pdf

Below are links to some of the reports and publications that can be downloaded from the Department of Labor’s Web site:

- Plan Fees Disclosure Form: <http://www.dol.gov/ebsa/pdf/401kfefm.pdf>
- “Understanding Plan Fees and Expenses”:
<http://www.dol.gov/ebsa/pdf/undrstndgrtrmmt.pdf>

Resources for participants:

- “A Look at 401k Plan Fees for Employees”:
http://www.dol.gov/ebsa/publications/401k_employee.html

You can talk personally with a representative of The Standard for more information. Call toll free at 877.805.1127 or visit us online at www.standard.com and click on Retirement Plans.

⁶ Matthew D. Hutcheson, “Uncovering and Understanding Hidden Fees in Qualified Retirement Plans,” http://www.401khelpcenter.com/pdf/mdh_understanding_fees_v2.pdf.

Glossary

12(b)-1 Fees

Mutual fund companies are legally permitted to charge mutual fund investors 0.25 percent to 1.00 percent of fund assets annually for sales, promotion, and marketing expenses. These 12(b)-1 fees, which are a part of a mutual fund's expense ratio are payable to sales associates and service providers.

401(k) Plan

A 401(k) plan is a defined contribution retirement savings plan (see definition below) for which the plan sponsor is typically a corporation.

403(b) Plan

A 403(b) plan is a defined contribution retirement savings plan (see definition below) for which the plan sponsor is typically a foundation or nonprofit organization.

457 Plan

A 457 plan is a defined contribution retirement savings plan (see definition below) for which the plan sponsor is typically a government entity.

Annuity

See "Variable Annuity."

Brokerage Window

Some providers offer trading platforms that allow participants to invest in mutual funds that are not offered through the plan's investment option line-up. These brokerage windows generally also allow participants to trade in individual stocks and other investment instruments that would otherwise not be available through the plan. There are generally additional setup costs for plan sponsors as well as annual and transaction costs for participants for this feature.

Bundled Providers

Some providers offer plan services bundled together in a one-stop-shopping package. These services include investment, recordkeeping, administration, and education services. Many bundled service providers can offer the entire range of administrative services such as Form 5500 preparation, plan documents and amendments, trustee services and more. To increase investment flexibility they may create alliances with investment management/mutual fund companies. Costs for offering a bundled/alliance plan are generally lower than an unbundled offering.

Custodian/Trustee

Custodians/trustees — typically banks, insurance and trust companies, and mutual fund companies — safeguard plan assets. This function is separate from recordkeeping, which tracks individual account activity and balances, but the recordkeeper does not necessarily handle plan assets.

Defined Contribution Retirement Savings Plan

In a defined contribution retirement savings plan, participants may direct their own investments through individual accounts. Investment returns and account balances depend upon the amount of participant and/or employer contributions, as well as investment performance.

ERISA

The Employee Retirement Income Security Act of 1974 is “a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry to provide protection for individuals in these plans,” according to the Department of Labor.⁷ The term ERISA is now used to refer to a series of laws and rules since 1974 that govern the organization, administration, governance, and oversight of retirement savings plans.

Expense Ratio

The expense ratio of a mutual fund pays for the costs of running a fund: asset management, administration and operation, and sales and marketing. The portion of the expense ratio that covers account servicing and sales costs are referred to as 12(b)-1 fees.

Fiduciary

According to the Department of Labor, the “persons or entities who exercise discretionary control or authority over plan management or plan assets, have discretionary authority or responsibility for the administration of the plan, or provide investment advice to a plan for compensation or have any authority or responsibility to do so” are considered plan fiduciaries.⁷ Plan fiduciaries assume both corporate and personal responsibility not only for decisions they make, but in some cases also for decisions made by others.

Insurance/Annuity Fund

See “Variable Annuity.”

Load

Loads are fees that are assessed when a fund is purchased (front-end load) or at the time of sale (back-end load). Back-end loads are typically reduced or eliminated after a given period of time.

⁷ U.S. Department of Labor, <http://www.dol.gov>

Management Fee

Investment funds charge a management fee for the costs of running the fund. Mutual fund fees are charged as expense ratios. Variable annuities charge a “wrap fee.” Privately managed/collective funds charge revenue sharing or shareholder servicing fees.

Mutual Fund

A mutual fund is a pool of individual investments — selected with a specific investment goal in mind and managed by a professional investment manager — in which shareholders own a representative portion. A mutual fund may consist entirely of stocks (or certain types of stocks), bonds, or money market instruments; or, it may include a combination of them. Some mutual funds have a pool of just a few individual holdings while others, such as an S&P 500 fund, may hold hundreds of individual stocks and/or bonds.

Recordkeeper

Recordkeepers are responsible for the tasks associated with tracking participant accounts. Some of these tasks include providing daily, weekly, or monthly valuation; processing investment transactions; handling participant requests for loans, QDROs, etc.; maintaining electronic platforms; and producing participant and plan sponsor reports.

Revenue Sharing

Investment fund companies are permitted to rebate some of their fees to other plan service providers through transactions that are referred to as revenue sharing. For example, many fund companies contract the job of tracking individual account activity to other providers. In turn, fund companies may compensate these providers for their services by way of 12(b)-1 or sub t/a fees.

Share Classes

Investment fund companies assign share classes to their funds as a way of indicating various underlying fee structures (i.e., Class A, Class B, Investor). These funds have the same underlying investments, but their fees vary depending on their share class designation. Some class shares include front and/or back-end loads. Others have higher expense ratios than others.

Unbundled Providers

Unbundled providers, including Third Party Administrators (TPAs), allow plan sponsors to pick and choose among a variety of vendors. In this case, the plan sponsor is providing the bundling service and may require additional internal staff to manage the plan. As with any highly tailored approach, fees for unbundled plans are often higher than a bundled approach.

Variable Annuity

Variable annuities are insurance company contracts; the returns earned by participants are tied to those of comparable mutual funds and other investment products. For example, the returns of an S&P 500 Index variable annuity would be similar to those of an equivalent mutual fund. In a variable annuity a “wrap fee” covers the cost of administration and management and may also cover the cost of an added insurance benefit risk (i.e., mortality risk).

Wrap Fee

A wrap fee “wraps” or bundles together the various fees associated with managing a variable annuity, including investment management, operations, administration, and marketing.



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