

Controlling Retirement Plan Costs

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Controlling internal and external retirement plan costs allows companies to offer competitive plans to employees.

In the tight job markets and increasingly competitive business environments that prevail today, an attractive benefits package is a virtual requirement. The benefits package is an important way for companies to differentiate themselves from their competitors and retain the best people.

Such benefits cost money, of course, but many companies mistakenly assume that the costs associated with such plans are impossible to control or manage. In fact, there are a number of costs associated with the plan that are

well within the realm of any company's prudent cost-containment measures.

Cutting Internal Costs

The internal, direct costs a company assumes to provide a retirement plan fall into two basic categories: cash contributions and personnel/administrative time. Contributions to the plan are specified in the plan document and are a selling point to the employees. A reduction in company contributions can cause a benefits package to be less competitive. However, it may be possible to establish a longer vesting period, which would reduce or eliminate the benefit ultimately provided to short-term employees. Ultimately, this will cut costs by allowing forfeitures to remain within the plan funds, offsetting the requirement for future contributions.

Although contribution costs are not subject to extensive cost-cutting measures, the administrative process presents significantly greater potential. Internal staff members are responsible for enrolling participants, answering questions, communicating with employees, processing distributions, administering loans and hardships and performing compliance requirements. Greater efficiencies in these areas will reduce costs over the long term.

The enrollment process, for example, can be modified from the practice many companies follow. Instead of requiring employees to work for the company for some minimum period before they may enroll, enrollment can take place simultaneously with the hiring process. Open enrollments should still be permitted on some regular basis, but the number of employees who would enroll this way would be reduced if new hires could elect enrollment at the time they are hired.

The communication process presents cost-reduction potential as well. Inevitably, employees will have questions about their benefits, and they should be encouraged to ask them. Answering them can be simplified with a ready-made hand-out answering frequently asked questions, for example (see Exhibit 1). The frequently asked questions could be posted on a bulletin board or on the company's Intranet as well. Where meetings are offered to help explain benefits plans, third-party administrators should take part as well. This will reduce the potential for the circulation of redundant, confusing or conflicting information.

Compliance is a time-consuming and, therefore, costly process. Curiously, many companies make it the responsibility of the plan administrator, the HR manager or even the chief financial officer to review documents to be sure all compliance matters are in order. These tasks can readily be performed by other members of the staff, however, and then simply passed up the corporate ladder for review and approval. The key to controlling internal costs is to focus on the ways the administrative staff is stretched and determine how personnel costs can be decreased by making the entire process more efficient.

Tackling External Costs

Typically, it is the external costs associated with retirement plans that are subject to prudent cost-containment initiatives. External costs include the plan design and other legal expenses, the external reporting requirements to regulatory agencies, communication, investment expenses, conversion and implementation costs, record-keeping and administrative fees and termination fees.

Plan Design and Legal Expenses

There are a number of complex and highly important steps associated with designing a retirement plan: drafting the document, filing for determination letters, filing related amendments and filing Internal Revenue Service fees. Only an ERISA attorney with significant experience should do the job. It is important to check the qualifications of the attorney, but there is no harm or shame in shopping for the best price among qualified attorneys.

Legal expenses can be reduced over the long term by carefully considering at the outset how the plan should be designed so as to reduce the need for amendments and subsequent filings. Additional features, like provisions for age-weighted or cross-tested plans, also can drive up the cost.

External Reporting with Regulatory Agencies

The Form 5500 filing often is offered by the third-party record keepers. However, the filing may be less costly when it is prepared internally and reviewed by an outside accountant or when it is prepared by an outside accountant. Depending on the size of the plan, the company also may be required to subject to an external audit. If it is required and left unmanaged, the external audit can become a cash bleed on the company.

The key to controlling costs associated with the external audit is to assure that the external auditor is qualified and experienced in this area and provide the auditor with good, timely information. The auditor will examine every aspect of the plan. The process is best kicked off with a meeting in which the auditor simply relates the kinds of information the internal staff should prepare and gather for the auditor. Internal staff should prepare as much of the data as possible before the audit begins. With the primary data, staff should also prepare supporting data for presentation.

Many auditors also offer a few hours of service at the outset for free, just to answer questions and assure the information-gathering process is complete. Companies should take full advantage of such an offering to make the audit as smooth and nondisruptive as possible.

Depending on the size of a given company, there also may be an internal audit department available. If such a department's staff were extended to the external auditor, the external auditor

EXHIBIT 1 Frequently Asked Questions about Benefit Plans

The following are questions employees frequently ask about benefit plans. A handout answering these questions about a specific employee benefit plan can reduce the time personnel spend answering questions, thereby reducing costs.

1. When do I become eligible to participate in the retirement plan?
2. Does the company make a contribution of its own?
3. If so, is there a matching provision?
4. Can I take a loan from the plan?
5. How frequently can I change my investment allocations?
6. How frequently can I change the amount withheld from my paycheck?
7. If I receive a year-end bonus, can I defer the entire amount?
8. When is the next scheduled education meeting with the investment provider?
9. Can I take a distribution from the plan before I retire?
10. What fees are assessed against my retirement plan account?

may find the process sufficiently simplified to warrant a reduced price.

Communication

Communication is a necessary component of a successful retirement plan. Employees must understand the plan if they are to value it as a benefit. Meetings with employees, printed materials, and Internet/Intranet access are useful in describing the plan features and encouraging participation. Service providers typically treat this kind of activity as an ongoing expense. When evaluating the service provider, it is important to understand what they will provide in this area and the associated cost.

Investment Expenses

Investment costs have undergone a great deal of scrutiny over the past few years. The U.S. Department of Labor and the pension welfare benefit administration have made more information available to employers and employees; the goal is to help both employers and employees make informed decisions on investment fees and how they relate to the plan in place.

In retirement plans, there are the following three categories of fees:

- one-time fees, which occur with a new plan or a conversion to a new service provider;
- ongoing fees, which relate to the plan's operation; and
- termination fees, which occur when certain services are terminated, a plan terminates or the service provider is terminated.

Specific fees are usually one of the following:

- asset based, which means the fee is based on the investments in the plan and usually are expressed in basis points;
- participant based, which means the fee is based on the number of individuals in the plan or eligible to participate;
- transaction based, in which fees are charged according to a transaction event, such as a loan or a distribution; and
- fixed fees, which are specified fees for services such as the preparation of Form 5500 and nondiscrimination testing.

If a plan invests in regulated securities, such as mutual funds, fees may be imposed with front-end load or back-end load, which are sales charges. Front-end load fees are incurred when a stock or

mutual fund is purchased. Back-end load fees are incurred when stock, mutual fund or other investments are sold. Mutual funds may also be subject to 12(b)1 fees, which are charges to cover a mutual fund's distribution and marketing costs.

Expense ratios are typically disclosed in the prospectus and are deducted from the assets of each fund. These expenses are paid by the individual directly because they are deducted from the funds directly. Expense ratios include management fees, marketing and distribution fees and other administrative expenses.

Management fees are paid for the management of the mutual fund or other collective funds portfolio by the investment manager. Costs include research, managers' compensation and the firm's profit margin, although they are a little more difficult to manage because they typically are not disclosed.

Insurance products are a different investment vehicle entirely. Insurance products are not subject to the Securities Act of 1933. Typically, the plan assets are packaged in a variable annuity. An insured variable annuity is one under which the benefit varies according to the investment results of an insurance company's separate account in which funds have been set aside to provide the annuity.

A group variable annuity is a wrapper around a bundle of mutual funds and general account investment options. The wrapper allows the insurance company to make guarantees, such as a minimum death benefit, a postretirement rate of return when an individual elects to pay out the funds in the form of an annuity and a guaranteed level of expense to be assessed against the assets of the account. Investment management fees are assessed on the mutual fund and then a wrap fee is assessed on the total assets in an annuity. The wrap fee will usually pay for the bundling of services in relation to investment charges and may include administrative costs such as record keeping.

For smaller plans, an individual annuity is often used when a group annuity is not warranted. An individual annuity is a contract in which an insurance company undertakes to pay a specified annuity. The investment management fees are similar to those assessed in a group variable annuity, but the wrap fees typically are higher.

Other costs associated with insurance products are mortality risk and administrative expense. These fees are imposed to cover the cost of the insurance features of an annuity contract, includ-

ing the guarantee of a lifetime income payment, interest and expense guarantees and any death benefits provided.

A variety of issues affect the way investment expenses are incurred and how they can be managed. These include the size of the plan, investment options available to participants and the transactions plan participants make. Regardless of size, there are a certain number of fixed costs involved in a plan, such as the design of the plan document, Form 5500 filings and discrimination testing. The size of the plan may indicate who pays for these services. A small plan may find it difficult to afford a traditional 401(k) and may want to investigate other options.

For investment options, the plan may incur more costs if a wider variety of options are offered; that can result in the availability of options with higher expense ratios. In addition, if daily valuation transactions are allowed, there is typically a higher expense associated with this. Many providers allow plan sponsors to invest in their family of funds as part of their package. In addition, they may give sponsors the option to invest in other fund families, which can increase charges because they are not the fund manager's funds.

With so many choices, it is important to assess costs carefully and weigh them against benefits. Generally, the number of transactions by plan participants will become the driving force in the cost of the plan; frequent, even daily, transactions typically have a higher price associated with them. Withdrawals and loans typically have a cost associated with them as well, and they can negatively affect the individual participants' account balances over the long term.

Conversion Costs

Once a plan is in place, changing the plan or selecting a new service provider can become a costly decision. When it is pursued for good reason, however, it is the ideal time to review a number of issues related to the plan and make any necessary changes all at one time (see Exhibit 2). Is the service provider meeting the needs of the sponsor and the participants? Are the investment vehicles performing in accordance with plan objectives? Are the fees and expenses in line with expectations?

The plan administrator should compile a list of plan features and compare them with plan objectives. Indeed, objectives may have changed since the plan was developed. Do participants want voice response and/or Internet access, for example, which may have been unavailable when

EXHIBIT 2 Plan Administrator List

Focusing on the cost-containment aspects of selecting a service provider, the following is a list of steps a plan administrator should follow in researching prospective service providers for a retirement plan:

1. Develop a detailed summary of the characteristics of the present plan or a new plan to be designed.
2. Select three reputable service providers to evaluate the services presently offered.
3. Detail and prioritize the features of the plan.
4. Provide parameters for investment options including an analysis of fees and numbers to be provided to plan participants.
5. Specify which fees the plan sponsor will absorb and which fees the plan will absorb.
6. Develop a detailed summary of the cost structure to be achieved, including specification of what will be included in the per-participant administrative charge.

the plan was established? An employee survey may be helpful in assessing whether participants believe the plan is accomplishing its objectives.

Once the plan administrator has determined the key features of the plan, outside service providers should be contacted for proposals. The plan administrator must prepare prospective service providers with extensive information, including the following:

- the features of the plan (such as loans via telephone, distributions via telephone),
- the desired number of investment options,
- the number of participants,
- total plan assets,
- reports to the plan sponsor and frequency of the reports,
- educational meetings,
- daily valuation fees that the plan will pay and fees that the plan sponsor will absorb.

To facilitate easy comparison of proposals, provide prospective service providers with a format they should follow in preparing their proposals. For example, request each provider to include a section called "investment options" that would list the investments available and all associated fees. Ask each provider to include an analysis of the costs relating to conversion, specifying which are one-time-only fees.

Conversion costs will include the implementation of a new plan document and enrollment of participants, including setting up participants on the computer system, verifying amounts to the prior record keeper's data, and setting up existing loans. Many times there is a blackout period during the conversion of plan assets.

Finally, it is important to seek clarification as to whether any services involve an extra cost, such as the annual nondiscrimination testing and the Form 5500 filing. And, of course, it also is important to check the references of the service provider.

Record-Keeping and Administration Costs

In addition to the day-to-day costs of managing the plan, administrative costs include updates for census data, the presentation of annual reports to the plan sponsor and the presentation of annual statements to participants. These costs are usually calculated on a per-participant basis. In addition, most plans assess a distribution fee for all withdrawals. If an annuity is paid to an individual, there is a separate fee associated with this also. Loan origination fees and loan maintenance fees also are assessed.

Generally, the key to cost containment in this area is comparative shopping. Service providers offer a wide range of fees in this area. It is important to compare service levels with fees, however, to assure that a lower fee does not translate into an unacceptably lower level of service. Loan fees can be addressed by either eliminating the loan provision from the plan or imposing a minimum loan amount.

Termination Fees

Termination fees are an integral part of the annual cost evaluation process. If a plan sponsor decides to change providers or terminate the plan, there will be costs involved. A full plan termination charge, back-end loan fees or transfer charges may be assessed. There also are charges associated with annuity and stable value/GIC products. In the event that the completion date of these contracts is not met, there are surrender charges to be paid on termination.

Evaluate the Plan Annually

The plan administrator should evaluate the costs of the plan annually (see Exhibit 3). Investment expenses should include an analysis of expense ratios, 12(b)1 fees and any wrapper fees by investment. In addition, record-keeping/administra-

tion costs should be tracked for education programs, enrollments, distribution expense, loan fee processing, balance inquiry expense and investment transfer costs.

The plan administrator also should consider the external audit fee, Form 5500 filings and fiduciary insurance premiums. The costs of the plan should be compared not only to prior years but also to the initial proposal to hold the service provider accountable. Any significant variances should be discussed with the provider and resolved between the two parties.

In addition to reviewing costs, the plan review also should focus on the service offered by the provider. Is the service timely? Are questions answered to the plan sponsor and the participants? Are answers adequate? Are voice response units and other resources as accessible as promised? If service has been comprised and costs seem out of line, it may be time to discuss with the provider or consider changing providers.

It also is helpful to consider who will pay for the numerous fees associated with the plan.

EXHIBIT 3 Annual Review Checklist

The plan administrator should perform an annual review of the plan to assess cost issues. The following is a checklist that would facilitate such a review:

- Plan Costs
- Actual Costs
- Prior Year Costs
- Costs Projected by Service Provider
- Investment fees by option
- Education costs
- Enrollment fees
- Distributions
- Loan fees
- External audit fee
- Form 5500 filing fee
- Fiduciary premium cost
- Legal cost
- Balance inquiry expense

Typically, investment fees are deducted from the participants' accounts, but the participant or the sponsor can pay withdrawal fees. The size of the plan may dictate who will pay which costs, but it is important to recognize that there are choices to be made in this area as well.

Retirement plans are a complex benefit to offer employees but a necessary one as well. Although sponsors are helpless to make the process any simpler per se, they hold much more control than they often realize over cost issues. Understanding and reviewing the costs regularly is the first step in controlling them.

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