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Fees: What You Get for the Money

by Robert L. Long, APM

Okay, I'll admit it—my wife and I are home improvement television geeks (HGTV and DIY). Even though we're close to completing an entire redo of our 25-year old home, we still enjoy new home improvement ideas and trends, and we still get excited about visits to The Home Depot and Lowes. An interesting and popular HGTV show these days is called "What You Get for the Money." The premise of the show is to explore what kind of home buying power exists in different areas of the country (e.g., What kind of home will \$500,000 get you in San Francisco compared to Des Moines, Iowa?). Wouldn't it be great if someone would create a similar type show to analyze what you get for what you pay in 401(k) administrative and investment fees?

In looking forward to the highly anticipated fee disclosure regulations to be released by the DOL, I've been trying to keep up on the volumes of articles being written on 401(k) fees. Many talk about fees as a bad thing. I found it quite interesting that very few, if any, focus on what a 401(k) participant or plan sponsor is receiving in return for the fees he or she is paying. The focus seems to always be on the level of the fee itself—not what you are getting. How do you compare a \$500,000 home in San Francisco with a similar priced home in Des Moines without having the opportunity to view and evaluate the home itself, as well as the town and the local environment? It also may seem outrageous that I have chosen to shell out \$200 for a new bathroom faucet just to wash my hands instead of the cheaper \$50 model. But what did I get for the money? Actually, I got a solid, high quality fixture that will service my bathroom for 20+ years. Too simplistic? Maybe...but maybe not.

A more realistic example:

- Participant A's 401(k) plan boasts an average expense of 30 basis points (bps). For that, the participant has a decent array of mutual funds, but is totally on his own to decide how to invest.



- Participant B's 401(k) plan has an average expense of 60 bps. For that, the participant also has a decent array of mutual fund options, but also has several online educational options and fund analyzers to assist in fund selection and monitoring.
- For an additional fee (let's say an extra 40 bps for a total of 100 bps or 1%), Participant B also has access to an individual advisor to annually help assess her progress and make appropriate adjustments.

On the surface (if you follow the conventional wisdom of today's pundits), Participant A is clearly better off because of lower expenses: 30 bps represents a huge savings over 100 bps. Maybe...but maybe not.

Don't be shy in justifying the fees you are charging to help your clients understand and appreciate your value proposition, but take the time to communicate that value clearly.

For argument sake, let's say Participant A is able to conjure up a 7% return on his own, for a net gain of 6.7%—not bad considering today's environment. Participant B, as a result of accessing the educational and analysis tools (there are a lot of good ones available), is able to generate an 8% return for a net gain of 7.4%. Hmm...pretty good. Then Participant B, recognizing the value in getting quality guidance, engages the advisor, who is able to bump her return to 9% for a net gain of 8.0%. [Remember, over the life of the plan, the additional net return ($8.0 - 6.7 = 1.35$) compounds.] Who is better off?

Clearly, the expense/return assumptions above are arguable. However, the point is that there are many variables involved in accurately assessing what represents a reasonable expense level. The value received in return for the expenses paid will ultimately determine how successful participants are in adding to their nest eggs. The best way to assess value and how it will impact the ability to accumulate assets is to evaluate the entire package—all of the expenses along with all of the services.

The same argument can be used for a plan sponsor. One might boast of average overall expenses of 50 bps. But what is the plan sponsor getting in return? Another sponsor may average 125 bps. Perhaps the sponsor paying the higher fee is receiving quality consulting and advisory services that make the plan much more effective and valuable for the participants. On the flip side, maybe the sponsor paying 125 bps isn't being serviced effectively and clearly is paying too much.


As we anticipate the dawn of fee disclosure guidance (it may be in our hands as you read this article), it is even more critical that plan sponsor and participants alike carefully review the entire package of services along with their associated fees. Reviewing a single piece of the puzzle in and of itself will have little value.

Here are a few additional variables (both for participants and sponsors) that must be taken into consideration when assessing value and determining what you are getting for the money. Learn to ask: "What am I paying for these services and how much will they help in the ability to accumulate assets for retirement?"

- **Educational tools:** These tools are extremely important in the world of participant direction. To what extent will they be utilized? How easy are they to use and how effective are they?
- **Analytical tools:** These tools measure risk and return and monitor performance and can help tremendously in keeping participants on track with their goals.

- **Access to advisors:** Practical, well disciplined and well educated advisors can bring great value to the table. Fees will go up, but often can be well justified.
- **Access to actively managed investment profiles or models:** The advisor will charge more for these options, but professional management may be very worthwhile for many participants.
- **Access to brokerage and managed accounts:** Clearly additional costs are involved with this option, but for many participants these accounts can be of great value, particularly managed accounts being managed by professional managers.
- **Open architecture:** Often open architecture will lead to more flexibility and increased fund options while reducing costs, but may not be appropriate based on the sponsors' needs.
- **Various consulting services:** Additional services, such as document and plan design services, distribution consulting and services for those nearing retirement, etc. can add value.

One more thought as we enter the brave new world of fee disclosure: if you are providing quality services and contributing value to plan sponsors and participants, then you shouldn't be concerned about fee disclosure. Everybody needs to get paid somewhere along the line—there are no free lunches, as the saying goes. Don't be shy in justifying the fees you are charging to help your clients understand and appreciate your value proposition, but take the time to communicate that value clearly.

In summary, we all likely agree that fee disclosure that results in an "apples to apples" comparison is a good thing. However, fees are only one piece of a very large puzzle. The entire value proposition must be carefully reviewed. So for sponsors and participants, the real question is "What do you get for the money?" 



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