

# Fee Transparency + Revenue Sharing = Good Deal

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There is a new but growing trend in the defined contribution 401(k) marketplace known as “Revenue Sharing Pricing” and for middle market plan sponsors looking for a way to control and reduce the long-term costs of their defined contribution retirement plans, it represents a significant positive development.

Plans sponsors have the ability to exert tremendous influence over the total cost of their plan by virtue of the investments they select from their service provider’s “fund universe” to be included in the core lineup. Service providers who embrace (1) full fee transparency and (2) revenue sharing create another avenue for sponsors to reduce and even recoup some of the long-term costs of the plan.

## **Two-Step Process**

Here’s how the process works. Think about how people buy cars nowadays (new or used, it doesn’t matter.) Someone decides on the car they want to buy and then researches to get the list price of the automobile. The list price represents the “cost” of the car direct from the manufacturer including profit before the dealer markup and if you know it, represents a powerful piece of information with which to negotiate pricing.

Now, let’s carry the analogy over to retirement plans. What if you knew the cost of the retirement plan? What if, for example, you are the sponsor of a

\$35mm 401(k) plan and you knew that the cost to provide all of the standard services was about 30 basis points including profit. If you know the cost of the plan then the next obvious question is what happens to the revenue generated in excess of 30 basis points. Knowing the cost of the plan allows smart plan sponsors to create a pricing model that will drive down the long-term pricing of the plan.

## **Revenue Sharing**

Over time, a typical 401(k) plan’s assets will grow more quickly than the cost to provide core recordkeeping and administration services. Historically, this “excess” revenue generated by the growth of the plan has been kept by the recordkeeper. By knowing the cost structure of the plan and knowing exactly how much the provider is receiving in fees from the investments selected, the plan sponsor can negotiate a pricing contract that will return the excess revenue back to the plan. Typically, this excess revenue is returned either directly in the form of reduced investment expenses (e.g., lower-cost institutional share pricing) or indirectly in the form of a “service credit” that can be used to pay for qualified plan expenses such as legal and consulting fees, employee education or investment advisory fees. However the excess revenue is returned to the plan, it’s clearly better off.

Last Summer, we assisted a mid-market client with a vendor search and because of their asset size of \$50mm and an average account balance of over \$100,000, we were able to negotiate a service credit of \$50,000 per year, a \$10,00 increase in the size of service credit for every \$10mm increase in total plan assets and a 20 basis point reduction in

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the cost of the stable value contract once the plan exceeded \$100mm in total plan assets.

Only a handful of service providers are embracing full fee transparency/revenue sharing model for obvious reasons. The ones with the most to lose are the companies who use the ERISA plan marketplace to distribute their proprietary investment product because this new pricing model creates downward pressure on their margins. But if you are a plan sponsor, the development of fee transparency and revenue sharing represents a powerful manner in which to ratchet down the long-term costs of your company's retirement plan.