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WALTHAM, MA, March 14, 2008 – With concurrent efforts underway at the Department of Labor and inside the halls of Congress, not to mention numerous class-action lawsuits proceeding through the court system, industry cognoscenti now agree that increased fee disclosure is imminent. The most important question then for defined contribution plan providers is “what additional information, guidance, or assistance do plan sponsors need, if anything at all?” The challenge in answering this question, however, is that fee disclosure is currently a latent need. If plan sponsors indeed have a need for additional information about how service providers are compensated or share revenue, they may not even realize that such a need exists.

A research study recently conducted by Chatham Partners reveals exactly that. On the surface, plan sponsors are comfortable with current disclosure efforts. But, beneath the surface, many of these individuals have a feeling that their level of knowledge about plan fees is insufficient considering the importance of the task. Concerns about potential legal action, higher plan expenses, and participants selecting suboptimal investments negatively impact these sponsors’ satisfaction with fees and increase the likelihood of considering alternative providers.

“Plan sponsors are starting to realize what they don’t know about fees. The collective epiphany is going to play into the hands of retirement plan providers at the leading edge of full disclosure,” noted Andrew McCollum, Managing Director at Chatham Partners.

Key findings from the research include:

Plan Sponsor Fee Disclosure Needs

- The vast majority of plan sponsors surveyed (77%) indicate that current disclosure levels are sufficient. Although it may be tempting to interpret this data point to suggest that sponsors are generally satisfied with fee-related disclosure efforts currently provided, such a conclusion would be impulsive. Only 58% of respondents feel confident about their understanding of their plan’s overall costs, despite realizing the importance of understanding these costs (79%). Furthermore, sponsors are clearly dissatisfied with the level of transparency offered by their existing providers, as evidenced by low scores given to fees are easy to compare to other providers (34% top 2 box score), revenue sharing is disclosed (38%), and fees are transparent (42%). Given these low satisfaction ratings and the importance sponsors ascribe to understanding plan costs, a need for “better” fee-related information clearly exists.
- The results of this analysis also reveal substantial perception differences depending upon the size of the retirement plan. The largest plans (>\$100 MM in assets) have a deeper understanding of plan fees and place greater importance on understanding plan fees than the smallest plans (<\$3 MM in assets). Interestingly, there appears to be a connection between level of understanding and satisfaction levels, as larger plans are also considerably more satisfied with all fee attributes, most notably the total cost of the plan and good value for the money. Additionally, there is noticeable variation between large and small plan sponsors with respect to their concerns regarding fee transparency and disclosure. Specifically, plans with >\$100 MM in assets are most concerned that lack of disclosure will lead to legal action by participants, while plans with <\$3 MM in assets are most worried that lack of disclosure will lead to higher plan expenses.

Plan Sponsor Fee Disclosure Needs (continued)

- Driven by potential mandates by the Department of Labor, Congress, SEC, or additional class-action proceedings, the smallest plans (<\$3 MM) are 2 times more likely than the largest plans (>\$100 MM) to consider alternative providers (17% vs. 8%). Additionally, plan sponsors who are “discontent” with current disclosure levels are almost 4 times more likely to consider alternative providers than plans that are “content” (27% vs. 7%). Small and discontent sponsors are seeking detailed descriptions of specific fee components, greater fee disclosure on employee statements, and specific details about revenue sharing arrangements.

Participant Fee Disclosure Needs

- Similar to results regarding the adequacy of plan sponsor fee disclosure, the vast majority of plan sponsors surveyed (74%) believe that participant fee disclosure is sufficient. However, it is clear that current disclosure efforts have not been entirely successful, as only 22% of plan sponsors report that participants are highly aware of the total cost to participants.
- Although plan sponsors indicate that participants do not have a solid understanding of DC plan fees, the majority of plan sponsors surveyed indicate that enhanced fee disclosure is important to their participants, as 65% rate this attribute a “5” or higher. That said, respondent commentary indicates that participants rarely inquire about fees, either due to lack of awareness, indifference, or both.

The Role of Pricing and Disclosure in the Evaluation Process

- Though few respondents indicate that fee transparency is the most important factor in their decision making process, the vast majority of plan sponsors surveyed (81%) indicate that it plays an important role in the outcome of their selection of retirement plan providers.
- Analyzing the elasticity of demand for various retirement plan services reveals that plan sponsors are most willing to pay higher fees to enhance services with greater opportunity for improvement, such as investment performance and employee education services. Conversely, plan sponsors are most likely to sacrifice co-fiduciary services and in-person enrollment and education meetings for reduced fees, with 22% of respondents reporting that they would accept reduced quality for lower fees in these areas.

Implication

The practical implication of this research for retirement plan providers is that blindly assuming that plan sponsors are content with current disclosure efforts – perhaps because that is what they have told you – or providing the minimum level of disclosure required by Department of Labor regulation is not an advisable strategic response. Providing easy-to-understand descriptions of specific fee components, communicating clearly about fiduciary fee disclosure responsibilities, and benchmarking administration fees, among other disclosure efforts, will become strategic imperatives in tomorrow’s competitive environment.

The 101 page report’s foundation is in-depth online surveys completed by 416 plan sponsors affiliated with corporate defined contribution plans ranging in size from \$1 MM in assets to more than \$1 BN in assets.

Chatham Partners, based in Waltham, Massachusetts, provides strategic advisory services and market research to the financial services industry.