Understanding Revenue Sharing

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1/21/2015

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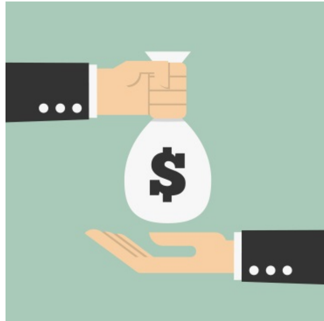
As the result of new Department of Labor (DOL) rules requiring detailed fee disclosures to qualified retirement plan participants and plan sponsors, there has been a lot of interest lately in fees related to retirement plan administration. Plan fees may be paid directly by the employer, they may be assessed against participant accounts as direct fees, or they may be assessed against plan assets as indirect fees. We see the most confusion with indirect fees that are calculated based on plan assets, with payments made through revenue sharing arrangements.



If fees for an ERISA-covered retirement plan are being charged to plan participants or are paid out of plan assets rather than paid directly by the employer, then the employer is *obligated* to evaluate such fees to be sure they are “reasonable.” Because of this obligation, it is important for the employer to understand the scope and quality of the services being provided to the plan, and how the fees for those services are calculated and paid. The payment of revenue sharing by some investment funds to service providers is often overlooked or misunderstood by plan fiduciaries as they struggle to evaluate the fees paid for the administration and investment services related to the plan.

Revenue sharing is a method that mutual fund companies use to compensate outside service providers. Additional non-investment fees are added to the expense ratio of the mutual fund and paid to the service provider. *The investment returns then reported by the mutual fund are net of these fees*. The amount of revenue sharing will vary by fund, with some mutual funds offering no revenue sharing arrangements. If the platform provider determines that the amount of revenue sharing it is receiving is greater than the cost to provide recordkeeping services to the plan, then a portion of the revenue sharing that is “profit” to the platform provider will be placed into an “ERISA expense account”, and that source of money is then available to pay other plan administration expenses, including third-party administration (TPA) fees, accounting fees, investment advisory fees or attorney fees. The ERISA expense account is typically not considered to be a plan asset and is therefore not included in the plan’s trust accounting. Deposits are made into the ERISA expense account throughout the year, and payments for plan expenses are then charged against the account as needed. Typically, any remaining money in the account at year-end is allocated to the participant accounts. The platform provider may also set up an automatic revenue sharing program with some of the outside plan providers, like the TPA, whereby a portion of the revenue sharing is automatically paid to the TPA each month or each quarter, rather than into the ERISA expense account.

As fiduciaries evaluate the prudence of the investment offerings inside the plan and the fees paid to various plan providers, they must also consider the indirect compensation that is built into the investment fees in the form of revenue sharing. The revenue sharing arrangement must be reasonable and in the best interest of plan participants.

As a TPA, Retirement Management Services has negotiated revenue sharing arrangements with many of the platform providers used by our clients. We may receive revenue sharing in the form of an "installation allowance," when a retirement plan is first created or moves from one platform to another, and as an ongoing fee-sharing arrangement. In both cases, the revenue sharing is based on the amount of assets in the plan. Typically, the revenue sharing is pre-determined as a set basis point calculation. For example, the service provider may pay us 5 basis points on plan assets (.05%) each year for our services. If the average plan assets for the year are $2,500,000, this would amount to $1,250 per year ($2,500,000 x .0005).

We have always taken the approach that the most transparent way to handle any revenue sharing arrangement is to fully offset our billed fees with 100% of all revenue sharing that we receive. So, in the example, our client would receive an invoice from us that reflects a $1,250 credit related to the revenue sharing. Not all third-party administrators treat revenue sharing arrangements the same way. Some offset the installation allowance but then collect the ongoing fees without offsetting them against billings. And some do not offset any portion of the revenue sharing they receive; instead, they set their regular pricing at a lower flat rate and then *keep* all of the revenue sharing payments as general income of the business. However, as assets grow in a retirement plan, the revenue sharing payment also increases, which means the TPA is being paid more and more each year for the same work. Plan fiduciaries must be diligent in understanding the amount of revenue sharing that is being paid to the third-party administrator each year to make sure it hasn't become unreasonably high relative to the services provided. Because RMS offsets our fees by any revenue sharing we receive, as the assets grow, the credit toward our fees also increases.

There has been a lot of speculation lately that due to the complexity in evaluating revenue sharing arrangements and the increased level of oversight that these arrangements require, plan fiduciaries are likely in the near future to opt out of them entirely. But for as long as revenue sharing arrangements and ERISA expense accounts are utilized by plans, fiduciaries must oversee these indirect payments and ensure they are not excessive.

Suzanne Tiano joined RMS in February, 2014 as Director of Sales and Marketing. Before joining RMS, Suzanne was a registered Financial Advisor with Protected Investors of America and worked for Aria Retirement Solutions as a Divisional Sales Director. Her previous experience includes serving as a Financial Advisor at Wells Fargo Advisors where she was dedicated to helping individuals and businesses develop financial and investment strategies in line with their needs, goals, and risk tolerance and working as the Marketing Director and Property Manager for Westport Village. Suzanne is a graduate of the University of Kentucky. Her mission at RMS is to provide every client with targeted, comprehensive plan services, delivered with the highest level of professional integrity. Suzanne holds a Series 7 and 66, and is securities and insurance licensed in all 50 states. She has four children and has lived in Louisville, KY for most of her life, where she is an active member of the community.

Diana E. Lindauer joined RMS in 2010 and became a Senior Plan Specialist II in 2013. She is a graduate of the University of Louisville with a Bachelor of Arts in Music. After nearly ten years as an on-air host for WUOL, Louisville's classical music radio station, she completed her business and accounting studies at the University of Louisville. Diana worked for four years in public accounting, gaining experience in audit and tax compliance for closely held businesses, with an emphasis in employee benefit plan audits. She is a licensed Certified Public Accountant, an active member of the Kentucky Society of Certified Public Accountants and the American Institute of Certified Public Accountants and also serves on the DuPont Manual High School Science Fair Board. She resides in Louisville with her two sons.

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