Fidelity charging new fee on Vanguard assets held in 401(k) plans

The 0.05% fee is ostensibly a response to Vanguard's distribution model, but may also make the company's funds less attractive due to higher cost

Jan 22, 2018 @ 4:59 pm
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Fidelity Investments, the largest record keeper of assets held in defined-contribution plans, has begun charging employers a fee on 401(k) assets held in **Vanguard Group** investment funds.

Starting this year, Fidelity will charge all new 401(k) clients a 0.05% fee on participant assets invested with Vanguard, which has emerged over the past several years as an index-fund behemoth as investors have **moved away** from active investing.

For example, a plan sponsor with $5 million in Vanguard assets would have to pay an extra $2,500 to Fidelity.

The fee doesn't apply to existing Fidelity clients and will be billed to the plan sponsor, not the plan participants.

Such a move, which observers say is the first of its kind, is ostensibly a response to Vanguard's distribution philosophy. The index-fund giant is the only fund family that doesn't pay Fidelity for shareholder and administrative services the company provides for access to Vanguard's funds.

Fidelity spokeswoman Nicole Abbott said the company is assessing the fee to address this "disparity" and provide "fairness across all its business relationships." Vanguard imposes some unique operational specs that add significant costs to administer its funds, she said.

Observers say such a fee also appears to be a competitive maneuver that will likely make Vanguard funds less attractive as a 401(k) option — especially among larger employers with big retirement plans — and could herald similar moves by record keepers beyond Fidelity. They also believe it speaks to Vanguard's overwhelming success in amassing 401(k) assets the past several years.

"I've never seen it where a record keeper has singled out one fund company and decided to put a specific fee on that fund company," said Aaron Pottichen, retirement services practice leader at the advisory firm CLS Partners. "It speaks to how dominating Vanguard is right now across the entire 401(k) landscape, and really how threatened everyone is by that."

However, Mr. Pottichen also believes assessing the 0.05% fee amounts to a smart business decision.

"Fidelity is a huge funnel of assets to Vanguard, and Vanguard hasn't had to pay any toll fees to Fidelity," he said. "Fidelity probably sees this as a free ride."

Fidelity provides record-keeping services for about $1.6 trillion of DC-plan assets, according to data tracked by *InvestmentNews* sister publication *Pensions & Investments*. That total exceeds that of its closest competitor, TIAA, by more than $1 trillion.

At the same time, Vanguard is the largest money manager of DC assets, overseeing more than $900 billion at the end of 2016, according to P&I data. A decade ago, the top spot belonged to Fidelity; in 2007, Fidelity managed roughly $540 billion in DC assets, while Vanguard managed around $320 billion.

Vanguard spokeswoman Laura Edling said Vanguard's "mutual ownership structure and operating model inhibits us from participating in revenue sharing," and as such the firm doesn't pay platforms or brokerage firms to sell its funds.

Some firms seem to have taken more drastic action in response to Vanguard's distribution model. For example, Morgan Stanley decided to **cut Vanguard funds** altogether from its wealth-management platform last year.

Philip Chao, principal and chief investment officer at advisory firm Chao &Co., sees Fidelity's move to charge an extra 0.05% as "both defensive and offensive."

It's defensive because Fidelity is currently losing money administering Vanguard funds, absent Vanguard paying for distribution, Mr. Chao said. However, Fidelity is acting offensively by making funds offered by Vanguard, a big competitor, more expensive for plan sponsors.

"Some of it is legitimate," Mr. Chao said. "But primarily they're trying to fight back against losing market share."