401(k) record keepers seek new revenue streams to 'save themselves'

Service providers are getting pinched by fee compression

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Record keepers of defined-contribution plans have begun seeking new sources of revenue, largely to defray relentless fee compression that's squeezing their bottom line, according to retirement plan advisers.

Record keepers, which track participant assets in defined-contribution plans, have responded in different ways. So far, some strategies have involved proprietary products, additional fees for plan sponsors and participants, sales incentives and pay-to-play arrangements, advisers said.

"They're looking to save themselves," Philip Chao, principal and chief investment officer at Chao & Co., said of record keepers. "The old ways are gone. They're doing it now because they didn't have to do it before — there was so much money swishing around," he said. "But with fee compression, it's damn near impossible to make any money."

Empower Retirement, which administers more than $570 billion in retirement assets, has a new product for small and midsize retirement plans that requires mutual-fund providers to pay for fund distribution, according to advisers familiar with the platform, called Empower Select.

Fund firms pay Empower in a tiered model based at least partly on how many funds they'd like to distribute, ranging from a few thousand dollars a year up to $1 million, advisers said. Some advisers are concerned that such an arrangement, which they believe is rare among other providers, will reduce transparency and represents a shift away from more investment choices for 401(k) plans.

Empower spokesman Stephen Gawlik declined to comment on the pricing model but said the platform, which is for plans with less than $50 million in assets, currently offers more than 200 fund families.

Empower Retirement maintains an open architecture record-keeping platform, as we believe the marketplace for investment solutions should be competitive," he said.

Advisers also point to a new fee that Fidelity Investments, the largest DC-plan record keeper, said it would start imposing this year on 401(k) assets held in Vanguard Group investment funds. The 0.05% fee, billed to the plan sponsor rather than the participants, applies to new plans with less than $20 million in assets.

Fidelity executives say the fee, which advisers call a first-of-its-kind move, is in the interest of fairness across its business relationships, since Vanguard is the only fund firm that doesn't pay Fidelity for shareholder and administrative services.

Advisers say the strategy also will likely drive clients to adopt Fidelity's proprietary index funds over rival Vanguard's because the fee essentially makes the latter's funds more expensive.

Record keepers' coffers have been getting pinched in a number of ways. Median record-keeping fees dropped by about half over 2006-16, according to NEPC, a consulting firm.

In addition, 401(k) plans are using their record keepers' proprietary funds — those offered by affiliated asset managers — less frequently than in the past, at the same time that investment fees also have been falling.

Advisers say record keepers have begun pushing proprietary products, such as target-date funds, managed accounts and stable value funds, with increased vigor.

Ellen Lander, principal of Renaissance Benefit Advisors Group, said she's seen an increased prevalence of record-keeping service proposals whereby the firm tries to entice use of proprietary funds by offering to slash its record-keeping fees if the plan does so.

The difference can be "dramatic," she said. For example, an insurance company may record-keep a plan for 0.10% of plan assets if the plan also includes its proprietary stable-value fund, but for 0.40% of assets without the fund.

Advisers say the practice isn't wrong, per se, but believe it reduces transparency and appears to flout plan sponsors' and advisers' obligations to choose a vendor not solely because of price but because it is the best service for the particular 401(k) plan.

"It feels like taking five major steps backward to perhaps what record keepers thought were the good old days," Ms. Lander said.

A previous InvestmentNews investigation found several record keepers such as Nationwide, Voya Financial and ICMA-RC started offering incentive compensation to their advisers and representatives for getting plan participants to enroll in their paid managed-account services.

Jania Stout, managing director of Fiduciary Plan Advisors, said record keepers also have begun charging a slew of additional administrative fees to larger plans for things like fund changes and plan mergers.

"These used to be things that just happened," Ms. Stout said.

Some advisers haven't witnessed some of the additional one-off administrative fees, however.

"I don't see people trying to find other ways to address the chase to zero on record keeping," said Shawna Christiansen, an adviser at Retirement Benefits Group.

To get around proprietary-product quotes in a bidding process, Ms. Christiansen asks record keepers to send service pricing without proprietary-product-use attached.