GRINKMEYER LEONARD FINANCIAL

401(k) INSIGHTS

NEWSLETTER & ALERTS

Understanding Revenue Sharing and the Flow of Money in Retirement Plans

As many plan fiduciaries can attest, retirement plan fees can be extremely complex and difficult to understand. This is due in large part to the lack of transparency surrounding plan fees and services, as well as the complicated and varying methods in which service providers are compensated.

Recognizing this problem, federal regulators passed new rules a few years ago requiring service providers to disclose their fees to plan fiduciaries and participants. Although these rules are a benefit to employers and employees alike, they placed increased pressure on plan fiduciaries to interpret and evaluate the appropriateness of service provider compensation—a task many fiduciaries still find difficult. More than ever, it's critical for employers to understand the various components of their retirement plans' fees, particularly indirect fees like revenue sharing arrangements.

The following describes common ways in which money flows through retirement plans. Each provider may operate differently, so be sure to check with your provider for information specific to your plan.

Service provider compensation
In general, plan fees cover expenses resulting from services provided in four primary areas:

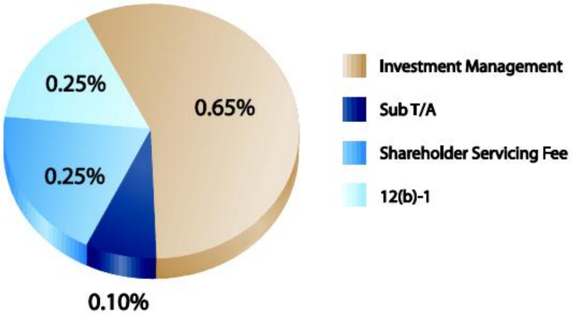
- Investments
- Recordkeeping
- Administration
- Advisory or brokerage services

These fees may be categorized as direct compensation, indirect compensation, or both.

Direct compensation: As its name implies, this type of compensation represents direct payments from the plan or plan sponsor to a provider for specific services rendered. It is typically paid as a flat dollar amount or as a percentage of plan assets. Fees that fall into this category often cover plan-level expenses, such as recordkeeping, administration, or advisory services.

Indirect compensation: Commonly known as revenue sharing, indirect compensation refers to fees generally collected from plan investments that are passed through to other service providers. Investment costs, including revenue sharing payments, often represent the majority of a plan's total fees.

The diagram on the next page illustrates the expenses of a typical equity-based investment that might be found in an employer-sponsored retirement plan.



The sum of all the fee components is known as the gross expense ratio. In this example, the investment has a gross expense ratio of 1.25 percent.

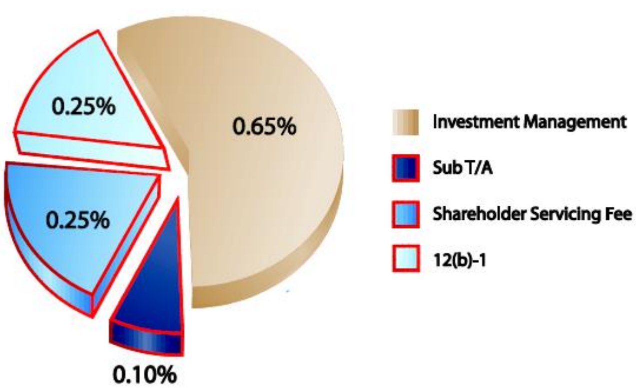
To help satisfy responsibilities under ERISA, when it comes to measuring fees, plan fiduciaries must understand each component and be able to assess its reasonableness in relation to the services provided.

- **Investment management:** The investment manager charges these fees for managing the investment.
- **Sub T/A:** These fees are paid to a subcontracted third party for the accounting of participant shares.
- **12(b)-1:** Found in more than half of all 401(k) investment vehicles, this fee represents (1) payment to a broker for the sale a fund, and (2) fees paid for the ongoing servicing of the account or plan.
- **Shareholder servicing fee:** These fees are paid in addition to 12(b)-1s for services rendered to the plan, such as recordkeeping and administration.

Revenue sharing for commission-based plans

In the employer-sponsored retirement plan industry, all components of the gross expense ratio, with the exception of investment management fees, are generally classified as revenue sharing. The following diagram describes common revenue sharing arrangements for commission-based plans.

	Fee Type		**Recipient**
Revenue Share	12(b)-1	→	Broker/Registered Representative
	Shareholder Servicing Fees	→	Recordkeeper, Administrator
	Sub T/A	→	Recordkeeper, Custodian, Other Third Party



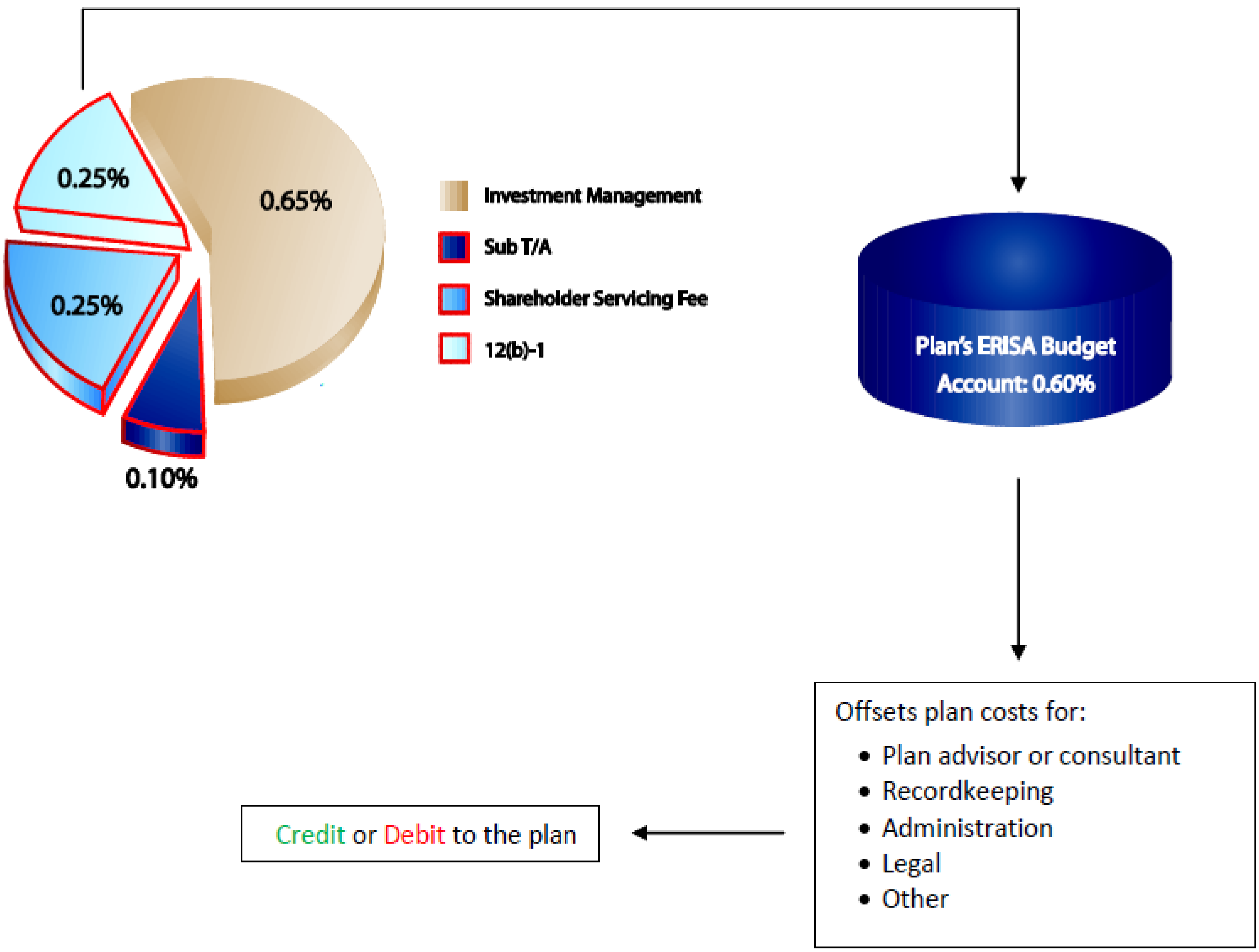
Revenue sharing components are highlighted in red in the chart to the left.

In this model, all revenue sharing is passed through the investment to the plan's service providers. The investment manager receives the investment management fee as direct compensation.

Revenue sharing for fee-based plans
Some recordkeepers have the ability to credit back revenue sharing fees to the plan. Often, this is done by creating an escrow account, known as an ERISA budget account, within the plan. This account collects all revenue sharing payments and then uses them to offset plan costs for services such as recordkeeping, administration, and advisory or consultant-related work. This model benefits plan fiduciaries by:

- Creating an environment ideal for assessing provider fees
- Reducing conflicts of interest among service providers
- Allowing for true independence when selecting service providers and investments
- Assisting in the fulfillment of fiduciary responsibilities

Above all, the transparency afforded by the fee-based model creates accountability on the part of service providers, which helps control plan costs.



A premium on independence: working with an advisor

When evaluating and managing retirement plan fees and services, fiduciaries need to determine:

1. Whether or not they can allocate enough time to properly assess and manage plan fees
2. If they have the skills necessary to properly evaluate the reasonableness of plan fees under the prudent expert standards defined by ERISA

For help navigating this complex world, many plan sponsors partner with independent consultants. Free from the constraints that restrict traditional brokers, independent advisors or consultants:

- May act as fiduciaries to the plan
- Can prudently assess the reasonableness of plan fees and services
- Generally have little or no proprietary vendor or investment requirements
- Seek to mitigate conflicts of interest
- Can facilitate the availability of ERISA budget accounts

For conscientious plan sponsors, hiring an independent advisor or consultant may be the most prudent solution to help meet fiduciary responsibilities in this changing environment.

"Revenue sharing" may also refer to additional compensation from investment companies to the broker/dealer in return for assistance in facilitating various marketing or educational activities, such as conferences.

About Grinkmeyer Leonard Financial

Grinkmeyer Leonard Financial is an industry leader in helping to provide focused, full-service defined contribution consulting services to employers looking for efficient, effective strategies for their retirement plans. We seek to help numerous employers just like you to maximize plan efficiency, minimize fiduciary risk, increase participation and diversification, boost investment possibilities, and improve the overall plan experience. Grinkmeyer Leonard Financial is a proud member of Retirement Plan Advisory Group, one of the largest independent consulting networks in the U.S. Learn more at www.grinkmeyerleonard.com.

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