Retirement Plan Fees & DROP:
Comparing Investment Costs for DROP Rollovers

Participants exiting DROP are faced with the challenge of deciding what to do with their DROP accounts. Leaving funds in DROP is not an option, and taking full cash distribution generally won't make good tax sense. Many participants roll their accounts to the City's Deferred Compensation Plan. Some prefer to self-manage their accounts through an Individual Retirement Account (IRA), while others seek professional investment management services. Regardless of your preference, it's important to understand how costs can vary depending on the type of investment vehicle chosen. This article will attempt to provide general information about potential costs in retirement investing so you can make informed choices.

Fees Matter – Some investors think certain investment choices or providers "don't have fees," or that investment fees are inconsequential because your investment will be growing in value. But evaluating fees should be as much a part of your decision-making process in retirement investing as it would be anywhere else. Just as if you were shopping for a new car or hiring a contractor, you need to know how much you will be charged before you can determine if the good or service is worth the price.

At the Deferred Compensation Plan we have an obligation, as does any potential investment advisor or provider, to make this information clear so you can understand it in dollars and cents. If a potential financial services provider cannot do this and you continue to be confused, dig further. Here are some tips for asking the right questions:

1 Understand the Costs of Investment – Retirement plan fees and expenses can be described in different ways and using different terms. Let's break them down into three very broad categories:

- **Investment Cost** – Paying an expert to make investment decisions on your behalf. If you invest in a mutual fund, for example, you are paying a presumed expert, the fund manager, to invest your assets. Common terms associated with investment cost include "expense ratio" in a mutual fund or "investment management fee" for a personal investment advisor/manager. Also included in this category are "early withdrawal penalties," common in certain mutual funds attempting to discourage frequent trading.
- **Administrative Cost** – The administrative (non-investment) costs of an investment; this includes issuing statements, operating a telephone service center or providing a website. Common terms associated with administrative cost include "asset-based fee," "custodial fee," "trustee fee" or "record-keeping fee."
- **Sales Cost** – Fees paid to an investment provider or third-party broker to purchase, or exit, an investment. They are not part of all investment options but when present can be significant. Common terms associated with sales costs include "commissions," "front-end load," "back-end load," or "sales charge." Other charges may be applied if you transfer or withdraw your funds before a certain period of time—these include "contingent deferred sales charges," common in certain insurance company investments.

Not all investment vehicles will include all three types of costs or fees, and not all providers will communicate them to you in these terms. For example, a provider may not charge an explicit "administrative fee" but will pay its administrative costs out of revenue collected from its investment management fees. In addition, some fees are not "explicit" in the sense they are not discretely identified on an account statement. This is typical of a mutual fund, where its fee is collected out of your investment returns before those returns are paid to you. Sometimes a fee will appear at the front-end and be deducted from your initial deposit, and sometimes a fee will only appear later when you withdraw from an investment.

2 Start with Understanding Your Deferred Compensation Plan Fees – In the Deferred Compensation Plan we make every effort to be fully transparent with fees charged in the Plan. Administrative costs are detailed on every statement, and investment management fees are provided in every quarterly newsletter. At approximately $5 billion in assets, the Plan has negotiated extremely competitive investment and administrative costs. In addition, the City's Plan has NO sales costs associated with any of its investment options.

Also, the firm providing administrative services for the Plan, Empower Retirement, has no relationship to any of the investment funds chosen for the Plan. There is no motivation for the counselor to steer you into any particular investment product. This may not be the case when it comes to outside financial service providers, who may be compensated from investments they direct you to.

3 Compare in Dollars and Cents – Using the City's Plan as a point of comparison, we suggest you nail down the relative costs of other options you might be considering. There are a wide variety of potential products, providers and fees, so think of the following illustration as only a very general example of what the cost differential might be.

Let's say you have $400,000 in DROP and are debating rolling the funds to the City's Deferred Compensation Plan vs. rolling them to an IRA managed by an investment advisor. The advisor indicates (s)he will charge a 1% annual management fee (investment cost), an amount fairly typical for these types of services. Let's say (s)he indicates your account will be invested in a variety of mutual funds which, on average, have fund management fees (investment costs) of 1%. This equates to a total of 2% in "investment cost." Let's also assume you will be charged a front-end load of 3% (sales cost). Finally, let's assume any administrative costs associated with this investment are recovered out of other revenue collected by the provider.

The City's Plan has an administrative fee of 0.10% (sometimes referred to as "10 basis points") or a maximum of $125 annually, that is waived for DROP accounts. You will, however, be charged a $25 annual custodial fee. If you invest your money in one of the City's broadly diversified asset allocation funds (for example the "Conservative Profile Fund") you will pay a fund management fee of 0.10% ("10 basis points," equal to 1/10th of one percent). Here is how the cost of these two investments could compare in the first year:

Retirement Plan Costs	Deferred Compensation Plan	IRA w/ Financial Advisor	Total Savings with the Deferred Compensation Plan
Investment Cost	$400	$8,000	$7,600
Administrative Cost	$25	$0	$0
Sales Cost (first year only)	$0	$12,000	$12,000
Total Cost	**$425**	**$20,000**	**$19,575**

4 Get it in Writing – Of course, the actual costs of any potential alternative could be higher or lower than this illustration. The only way to know for sure is to require that a potential financial services provider disclose ALL fees to you, direct or indirect, explicit or implicit, on your investment and any investment earnings on an annual basis, and ask for an illustration based on a hypothetical dollar investment (for example, $100,000). The provider should be able to verify to you, in writing, that this illustration represents all of the direct or indirect fees which would be assessed out of your investment or potential investment earnings. A Empower Retirement counselor will be happy to provide a similar illustration for the City's Deferred Compensation Plan. Using illustrations in dollars and cents allows you to make apples to apples comparisons.

5 Consider Your Objectives – Consider what you're trying to achieve with the investment provider. For many of us, a certain level of anxiety is associated with making investing decisions. This is why many investors are willing to hand over that decision-making to a perceived expert. In the Deferred Compensation Plan we like to remind investors there are three basic keys to successful investing: (1) identifying the level of risk you are willing to take; (2) diversifying your investment in a manner consistent with your risk tolerance; and (3) managing the cost of investment so it doesn't eat too deeply into your returns.

The City's Deferred Compensation Plan is a City-sponsored employee benefit program. The Plan provides four local counselors who can help you identify your risk tolerance and match your investments to that risk tolerance. The City's Plan also has a range of investment choices to help manage the cost of investment. Because neither the contractor nor City staff who work with the Plan are compensated based on your investment choices, they can provide you with objective information if you need help evaluating your options. If this service is consistent with your objectives, cost might be a deciding factor.

6 Take Your Time, Preserve Your Options – Because you have to roll funds out of your DROP account upon retirement, you may feel you're under some pressure as you approach your final retirement date. One way to ease the pressure is by rolling your funds to the lowest-cost option (which may be the Deferred Compensation Plan) and then taking time to investigate. If you happen to be considering rolling both your DROP as well as Deferred Compensation Plan accounts to an outside provider, remember that once you roll out everything you don't have the option of rolling back in. So, to keep all options on the table, consider leaving at least a small balance in the City's Plan.

If you've decided to roll your money to the Deferred Compensation Plan, you can call (888) 466-0381 to request the DROP rollover packet. You're also welcome to complete the forms necessary in person by visiting City Hall, 200 N. Spring Street, Room 867 Monday through Friday from 8:00 a.m - 4:00 p.m. and speaking with one of the Plan representatives in the City's Employee Benefits Division.

7 Remember, Value Matters – Perhaps the most important thing to keep in mind is that value matters in retirement investing as much as any other area of life. Many individuals will spend weeks or months debating the purchase of a $25,000 vehicle, but only a few minutes deciding how to invest $250,000. Don't be shy in looking out for this significant asset you've accumulated. As always, you are your best advocate.

Representatives of the City of Los Angeles Deferred Compensation Plan cannot offer investment, fiduciary, financial, legal or tax advice. Please consult with your financial planner, attorney and/or tax advisor as needed. Please consider the investment objectives, risks, fees and expenses of any prospective investment carefully before investing.