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

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Police Officers exiting DROP are faced with what can feel like a daunting challenge of deciding what to do with the funds in their accounts. Leaving it in DROP is not an option, and taking a full cash distribution of the account generally won't make good tax sense. Many Officers roll their accounts to the City's Deferred Compensation Plan if their goal is to invest their DROP funds in a manner consistent with how they've invested their Deferred Compensation Plan assets. Some may prefer to self-manage their accounts through an Individual Retirement Account (IRA), while others may 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 you with some general information about potential costs in retirement investing – so that you can determine if those costs are worth the product or service you are purchasing.

Fees Matter – Some investors think that 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 these 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 to you, so that you can understand the answer in dollars and cents. If a potential provider cannot do this and you continue to be confused, this is a signal that you need to dig further. Here are some tips for asking the right questions of potential providers and advisors so you can make well-informed decisions that are in your best interests.

(1) Understand the Costs of Investment – Retirement plan fees and expenses can be described in different ways and using different terms. It might be helpful to break them down into three very broad categories:

- Investment Cost – This is essentially 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.
- Administrative Cost – These costs would include the administrative (non-investment) costs of an investment. For example, this might include the cost

of issuing statements, operating a telephone service center or providing a website, etc. Common terms associated with administrative cost include "asset-based fee," "custodial fee," "trustee fee" or "record-keeping fee."

- Sales Cost – These are fees paid to an investment provider or third-party broker to purchase, or exit, an investment. They are not part of all investments options but are something to be aware of, because when applied they 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 are called "contingent deferred sales charges," and are 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 this simply. For example, a provider may not charge an explicit "administrative fee" but will pay for its administrative costs out of the revenue it collects from its investment management fees. In addition, some fees are not "explicit" in the sense that 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. It may appear that you're not paying a fee but, of course, you are. 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. This is why translating the various ways that fees are communicated is so important to understanding how much you're really paying.

(2) Start with Understanding Your Deferred Compensation Plan Fees – In the Deferred Compensation Plan we make every effort to be fully transparent with the fees charged in the Plan. Administrative costs are detailed on every statement, and investment management fees are provided in every quarterly newsletter. The City's Plan strives to take advantage of its size to pass along the lowest fees possible to its members, and this is why the Plan will tend to be a very competitive option for investing your DROP money.

Keep in mind that the City's Plan does not "profit" from the rollover investment you might make. The firm which provides administrative services for the Plan (Great-West Retirement Services) has no relationship to any of the investment funds chosen for the Plan. Great-West local counselors are salaried and will not profit based on any investment decision you make. As a result, there is absolutely 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 managers marketing IRAs. Unless you work with a fee-only financial planner, an outside investment advisor is likely to be compensated based on a percentage fee applied on your account or in compensation received from investments he/she directs you to.

Also, as indicated earlier, the City's Plan is difficult for an outside provider to compete with from a cost perspective. At $2.5 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.

(3) Comparison Shop – Using the City's Deferred Compensation 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 $100,000 in DROP and are debating either rolling the funds to the City's Deferred Compensation Plan or rolling them to an IRA that will be 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 would 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% (a sales cost). Finally, let's assume that any administrative costs associated with this investment are recovered out of the other revenue collected by the investment manager or provider.

The City's Plan has an administrative fee 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% (sometimes referred to as "10 basis points," and equal to 1/10th of one percent). There are no sales costs associated with any of the City's investment options. Here is how the cost of these two investments would compare in the first year:

Retirement Plan Costs	Deferred Compensation Plan		IRA w/Financial Advisor	
Investment Cost	$	100	$	2,000
Administrative Cost	$	25	$	0
Sales Cost (first year only)	$	0	$	3,000
	$	125	$	5,000

(4) Get it in Writing – The above illustration provides a fairly dramatic illustration of the potential cost differential. Of course, the actual costs of any potential alternative could be higher or lower. The only way to know for sure is to require that a potential investment advisor or manager disclose ALL fees to you, direct or indirect, explicit or implicit, on your investment and 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 investment earnings. A Great-West counselor will be happy to provide a similar illustration for the City's Deferred

Compensation Plan for you. Using an illustration in dollars allows you to make apples to apples comparisons with the City's Deferred Compensation Plan as well as other potential providers.

(5) Think About Investment Decisions – 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 that 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 that 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 with identifying your risk tolerance and matching your investments to that risk tolerance. The City's Plan also has a range of low-cost investment choices which can help you manage the cost of investment. Because neither the contractor nor the City staff who work with the Plan are compensated based on your investment, they can provide you with objective information if you need help evaluating your options. This service is available to you at any time, and you should feel free to take advantage of it, regardless of the decision you ultimately make.

(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. DROP accounts may have hundreds of thousands of dollars in them – so there's every reason in the world to take your time making your decision. 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 your options on the table, consider leaving at least a small balance in the Deferred Compensation Plan. This keeps your account open and the option to roll back into the plan remains.

(7) Value Matters – Perhaps the most important thing to keep in mind is that value matters in retirement investing as much, if not more, than 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 are not registered investment advisers, and cannot offer financial, legal or tax advice. Please consult with your financial planner, attorney *and/or tax adviser as needed. Please consider the investment objectives, risks, fees and expenses of any prospective investment carefully before investing.*