As fees on 401(k) retirement plans decline, more employers are changing the way they apportion the plans' administrative expenses among participants.

In recent years, more mainly large and midsize 401(k) plans have moved away from revenue-sharing arrangements to impose separate, explicit administrative fees. PHOTO: EUROPEAN PRESSPHOTO AGENCY

By ANNE TERGESEN
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The changes can result in some workers paying more than before, even as administrative costs on average fall.

Administrative fees—which cover expenses associated with services including record keeping, call centers and mailings to participants—typically comprise about 18% of a 401(k) participant’s total fees, according to Deloitte Consulting LLP. Investment-related fees make up the rest. In 2015, median administrative fees hit an all-time low of $64 per participant, down from $70 in 2014 and $118 in 2006, according to investment consulting firm NEPC LLC.

In the past, 401(k) administrative costs were often invisible to participants. The reason: Under an arrangement known as revenue sharing, most employers chose to cover administrative expenses via fees built into the mutual funds offered as investments in the plan.

But in recent years, more mainly large and midsize 401(k) plans have moved away from that arrangement to impose separate, explicit administrative fees.

The percentage of plans covering administrative fees via all-in-one revenue-sharing arrangements tumbled to 40% in 2015 from 83% in 2011, according to Aon Hewitt, a human-resources consulting firm. Another 14% of plans report they are “very likely” to take similar steps to restructure administrative fees this year, says Alison Borland, head of defined contribution at Aon Hewitt.

Experts say the changes have been fueled in part by a shift on the part of 401(k) plans toward lower-cost investments, including index funds and collective trusts that typically don’t include fees used to help pay administrative costs.

An issue of equity arises if a 401(k) offers both supercheap index funds and shares of actively managed mutual funds that include fees to cover administrative expenses. Participants who put all of their 401(k) dollars into the index funds may pay no administrative fees at all, with the burden falling on those who use the actively managed funds.

“It all gets down to what is fair and how do you get people to shoulder their share of the administrative fees,” says Lori Lucas, defined-contribution practice leader at investment consulting firm Callan Associates Inc.

As they attempt to spread the burden of administrative fees more fairly, plans are adopting a couple of approaches. Each arrangement favors some participants over others.
Some plan administrators are charging participants a uniform percentage of their account balances—for example, 0.1% a year—while the plan continues to offer some funds with revenue-sharing arrangements. Such plans refund money to participants with mutual funds that pay more than the target percentage, while levying an extra fee on those whose funds pay less.

That accounting can cause confusion for participants, as they “encounter fee credits on their quarterly statements” or see charges that weren’t there before, says Earle Allen, a partner at retirement-plan consulting firm Cammack Retirement Group Inc.

Other employers are eliminating funds with revenue-sharing payments and solely charging separate administrative fees. There are different winners and losers if they switch to percentage-of-assets or flat-dollar charges, depending on the size of people’s accounts.

For example, if your plan charges a flat $50 annual administrative fee and you have a $5,000 balance, you will pay 1% of your balance for administrative fees—far higher than average. In contrast, someone with a $500,000 balance will pay only 0.01%. (Some companies waive or reduce these fees for workers with small balances.)

In a plan that charges a uniform percentage—say, 0.1% of assets—those with lower account balances pay less in dollars for the same services. For example, a participant with a $500,000 balance will pay $500 while someone with a $5,000 balance will pay $5.

While “no fee system is perfect,” the fixed-percentage approach is the most fair, concluded a recent paper by TIAA Institute, a division of financial-services firm TIAA that conducts research on financial security. By contrast, it said, a flat-dollar fee places “additional administrative cost burdens on younger, lower-income and less wealthy workers.”

Equity isn’t the only reason employers have changed how they charge 401(k) participants for administrative expenses.

Employers have also backed away from 401(k) revenue-sharing arrangements in the wake of class-action lawsuits that have challenged the practice—thus far, largely unsuccessfully—on the grounds that it can lead to conflicts of interest, says Stephen Rosenberg, an attorney at the Wagner Law Group in Boston.
A conflict can arise because a plan or its administrator may have an incentive to choose investment options with higher revenue-sharing payments, says Scott Parker, a principal at Deloitte Consulting LLP. “One way to reduce those potential conflicts is to get rid of revenue sharing entirely.”

Still other employers are ditching the arrangement because they prefer to have the plan incur a fixed dollar amount per participant for administrative services, rather than an amount that automatically rises when a bull market pumps up account balances.

Experts say the trend gives plan sponsors leverage to bargain for lower fees. “When fees were bundled, there wasn’t as much pressure on plan sponsors to assess every fee,” says Ms. Borland. Now that fees are broken out separately, each is “on the table for negotiation,” she adds.

To see how much you are paying, check the annual fee disclosure your plan sends you. These generally specify how administrative fees are paid, Ms. Borland says.

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