Retirement plan share classes: Understanding the basics

Choosing mutual funds for your retirement plan's investment lineup can feel like wading through a sea of alphabet soup. Fund companies typically offer multiple share classes, each sporting its own unique letter. A shares, C shares, I shares, R shares — what does it all mean? Luckily, you don't have to be a mutual fund expert to understand the different share classes. Here's a brief primer to help you understand the basics.

ABCs of Fees

Before diving into the share class alphabet soup, first, a brief word about fees. Each share class of a mutual fund owns the same underlying securities (stocks, bonds, etc.); the only difference is the cost. These come in two basic varieties: expense ratios and sales "loads."

Expense ratios are the percentage of a fund's assets used to cover administrative, marketing and distribution (12b-1 fees), and all other costs. Typically paid by participants, these fees are calculated annually as a percentage of an investor's assets. For example, a participant would pay $150 for a $10,000 balance invested in a share class with a 1.5% expense ratio.

Additionally, certain share classes charge significant sales loads. However, these are typically waived for mutual funds purchased through 401k plans.[1] If this is the case, neither the plan nor its participants pay these fees.

How to Compare Shares

Now, let's talk share classes. Here's a primer of the most common share classes:

A shares: Charge a front-end load for sales commissions for financial planners, brokers and investment advisors. It's paid when shares are purchased and is calculated as a percentage of the original investment. For example, if the opening balance is $5,000 with a 5% front-end load, the fee is $250, making the invested balance $4,750. Within retirement plans, these costs are generally waived in retirement plans.

C shares: May be "no-load" funds, or those that carry a back-end load, in which an investor may pay a sales charge — typically 1% — if shares are sold within a specific period of time (generally less than a year). However, within retirement plans, a back-end charge is typically waived. Class C shares also carry higher expense ratios than A shares.

I shares: Known as "institutional" share classes, I shares typically carry much lower fees than A or C shares. While A and C shares are available to most plans of all sizes, they are mostly accessible to larger plans.[1]

R shares: Specifically designed for retirement plans, R shares range from R-1 to R-6. R shares typically don't have front- or back-end loads; however, they may potentially carry a revenue-sharing component. As such, expense ratios vary: those with 12b-1 marketing and distribution fees may range from .25% to 1%.[2] It is worth noting that

R-6 shares generally have no 12b-1 or servicing fees, although they are typically only available to plans with assets of $10 million to $250 million.[3]

CITs: Collective Investment Trusts (CITs) are the new kids on the investment block. They are similar to mutual funds; however, there are major differences. CITs are not registered; therefore, their administrative expenses are typically lower than those of mutual funds because they are not subject to the many regulations that mutual funds must abide by. Mutual funds are open to the public, whereas CITs are not, and are designed to be part of a specific 401(k) investment strategy. Keep in mind that CITs do not have traditional Ticker Symbols, so while they might have lower costs, there is also a lack of investment transparency. As a plan fiduciary, it is a best practice to truly understand the investment structure, weigh the potential cost savings, and compare the benefits with implementing CITs.[4]

What's more, new share classes — T and "clean" shares — have emerged in response to changing regulations. These share classes are designed to promote greater fee transparency and level the playing field on commissions for financial professionals, while enabling plan sponsors to distinguish investment costs from plan costs.

The bottom line: when selecting and reviewing mutual funds for a plan's investment menu, it's important for sponsors and fiduciaries to understand the different share classes and their related fees, as well as how they impact plan costs and participants' ability to optimize their retirement savings. As you review the many different options available out there, remember: "you must choose, but choose wisely."[5]

[1] Simon, Javier. Planadviser. "Understanding Share Classes in DC Plan Funds." May 2017.
[2] Investopedia. "What is a 12B-1 Fee?" Aug 2016.
[3] Simon, Javier. Planadviser. "Understanding Share Classes in DC Plan Funds." May 2017.
[4] Morningstar Office. "What is a Collective Investment Trust?" November 2018.
[5] Boam, Jeffrey; Kaufman, Philip; Lucas, George & Meyjes, Menno. "Indiana Jones and the Last Crusade." May 1989.