

# HIDDEN 401(K) FEES: HOW DISCLOSURE CAN INCREASE RETIREMENT SECURITY

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## HEARING BEFORE THE SPECIAL COMMITTEE ON AGING UNITED STATES SENATE ONE HUNDRED TENTH CONGRESS FIRST SESSION

WASHINGTON, DC

OCTOBER 24, 2007

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## **HIDDEN 401(K) FEES: HOW DISCLOSURE CAN INCREASE RETIREMENT SECURITY**

**WEDNESDAY, OCTOBER 24, 2007**

**U.S. SENATE,  
SPECIAL COMMITTEE ON AGING,  
Washington, DC.**

The Committee met, pursuant to notice, at 10:32 a.m., in room SD-628, Dirksen Senate Office Building, Hon. Herb Kohl (chairman of the committee) presiding.

Present: Senators Kohl and Smith.

### **OPENING STATEMENT OF SENATOR HERB KOHL, CHAIRMAN**

The CHAIRMAN. This hearing will come to order. Good morning. I would like to welcome our witnesses and thank them for their participation. We are here today to bring attention to an important issue affecting the retirement security of millions of Americans.

More and more Americans are relying on 401(k) plans to provide their retirement income. Although these plans have only been around since the 1980's, they now cover over 50 million people and exceed \$2.5 trillion in total assets. Out of private sector workers that have any type of retirement benefit, two thirds have only their 401(k) savings to secure their financial well being into their retirement.

Although 401(k)'s have become the primary pension fund for most Americans, there are few requirements for fund managers to tell participants how much they are paying in fees. Most fees are either absent or obscured in participant statements and investment reports. Not surprisingly, we will hear today that fewer than one in five participants know the fees they are paying.

Unfortunately, the lack of disclosure and the lack of understanding can have serious consequences for an individual's retirement savings. The slightest difference in fees can translate into a staggering depletion in savings, greatly affecting one's ability to build a secure retirement.

According to the Congressional Research Service, families who save their retirement funds in high fee accounts could have one-quarter less in retirement than those who work for employers who offer low-fee accounts. For couples who save their entire lifetime, the CRS study found that an annual fee of 2 percent could reduce savings by nearly \$130,000 compared to a more reasonable fee of 0.4 percent.

Investigations by this Committee have found that fees at 2 percent or higher are not uncommon. One small business owner we talked to with contract fees around 2 percent, and most of the



plans assets in a money market account had a net return that was almost a negative 1 percent a year. The small business owner was distressed when he finally discovered the high charges, and was ready to cancel his 401(k) plan altogether.

Giving small business owners all the facts in an easy-to-understand manner will help them find lower cost options and make it more likely that they will offer retirement savings plans to their employees.

Fees are not the only factor that 401(k) participants should consider when deciding how to invest their savings. A wise investor should diversify portfolio and consider a funds risk and return.

But while returns are unpredictable and will fluctuate from year to year, fees are something that are fixed, are known in advance, and could be easily controlled by plan enrollees. Furthermore, we believe there is a basic right for consumers to clearly know how much products and services are costing them.

This week, Senators Harkin and myself are introducing the Defined Contribution Fee Disclosure Act of 2007. This bill will help shed some light on these fees by requiring complete transparency to both employers and participants. This will allow employers to be able to negotiate with pension fund managers in order to get the lowest possible fees for their employees.

Participants will be able to make informed choices between investment options and potentially increase their retirement savings by thousands of dollars. Ultimately, this legislation will help to lower costs for everyone by fostering competition among pension managers.

So, we welcome our witnesses as we discuss the importance of fee disclosure to employers and plan participants and consider its impact on the retirement savings of older Americans.

We turn now to my able Ranking Member and my friend, Gordon Smith, from Oregon.

#### **OPENING STATEMENT OF SENATOR GORDON H. SMITH, RANKING MEMBER**

Senator SMITH. Thank you, Chairman Kohl. I appreciate your holding this important hearing. Our topic today is hidden 401(k) fees and how disclosure can increase retirement security.

One of my priorities on this Committee has been to ensure that Americans are financially secure in retirement. With uncertainty surrounding Social Security and the shift from employer-sponsored defined benefit plans to defined contribution plans, more and more of the responsibility for preparing for retirement rests on one's own shoulders. Unfortunately, though, American retirement savings rate for 2006 was a negative 1 percent. This is the lowest rate since 1933 during the Great Depression.

Clearly, Americans need to save more for retirement. I have been working over the past few years on ways to help Americans do just that. For example, I worked to enact legislation that would encourage employers to adopt automatic enrollment in 401(k) plans. This is a simple idea that has been shown to increase plan participation significantly.

I was very pleased that we were able to enact automatic enrollment as part of PPA—that is Pension Protection Act, if any of you,

like me, get too many alphabets around here—and I am confident that provision is helping to increase participation rates in 401(k) plans.

Now, I am pushing for other proposals to increase Americans' retirement savings. For example, one of my bills would require employers to allow long-term, part-time employees to make contributions to their 401(k) plans. However, the goals of these proposals may be undermined by excessive 401(k) plan fees.

Fees are one of many factors, such as investment risk and diversification, that participants should consider when investing in a 401(k) plan. But excessive fees can undercut Americans' retirement security by reducing their savings. Simple as that.

In light of this, I was very disturbed to hear about AARP's recent survey results on 401(k) participants, their awareness and understanding of fees. About two-thirds of the respondents stated that they do not pay fees, and when told that 401(k) providers typically charged fees for administering the plans and that the fees may be paid by either the plan sponsor or participants, 83 percent then acknowledged that they do not know how much they pay in fees.

Clearly, 401(k) participants need additional information on plan fee and expenses. However, it is important that, as we get them more information, we don't overwhelm them. The additional information need to be concise, meaningful and readily understandable.

If we bombard participants with too much information, they will do what most people would do—they will ignore it. Since any new disclosure requirements will carry costs for participants, overloading them helps no one.

So, I am pleased that the Labor Department has begun a series of regulatory initiatives to increase transparency and disclosure of plan fees and expense information. I look forward to hearing more about these initiatives today, and I would like to continue to work with the Labor Department to ensure that participants have the fee information they need to make prudent investment decisions.

Thank you, Senator Kohl.

The CHAIRMAN. Thank you very much, Senator Smith.

We are pleased to welcome our first panel here this morning. The first witness will be Barbara Bovbjerg. Ms. Bovbjerg is the director of Education, Workforce and Income Security Issues, for the U.S. Government Accountability Office. At the GAO, she oversees evaluative studies on age and retirement income policy issues, including social security, private pension programs, and the Employee Benefit Security Administration of the Department of labor.

Our second witness will be Brad Campbell. Mr. Campbell is the assistant secretary of Labor for the Employee Benefit Security Administration, which oversees more than 700,000 defined contribution retirement plans that cover almost 150 million Americans. In this capacity, he is responsible for the administration and enforcement of Title I of the Employee Retirement Security Act, which is known as ERISA. He has been with the Department of Labor since 2001.

We welcome you both, and, at this time, we will take your testimony.

Ms. Bovbjerg.

**STATEMENT OF BARBARA BOVBJERG, DIRECTOR, EDUCATION, WORKFORCE AND INCOME SECURITY ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC**

Ms. BOVBJERG. Thank you very much, Mr. Chairman, Senator Smith. I am pleased to be here today to speak about disclosing fee information to 401(k) participants and providing better fee and cost information to 401(k) sponsors, because fees can significantly erode an individual's 401(k) savings, as you noted.

Information about the fees being charged is important because we expect individuals to be responsible for making wise decisions about their accounts. Sponsors, as fiduciaries, need the information necessary to make plan design and administration choices that are in the best interest of the participants.

Today I will present information about how such disclosure might take place. I will speak first about what information could be most useful, and then about how such information might be presented. My statement is drawn from our work last year on 401(k) fees and from reports we have issued over the last several years, addressing the presentation of financial information.

But first let me speak about the "what," what information to provide. Although it is clear that participants need basic fee information, it is not so clear what information is most relevant to them.

Most would agree that participants at least need to know what direct expenses are charged to their accounts. In our earlier report on this topic, we recommended that participants at least get information that allows them to make comparisons across investment options within their plans. We suggested that expense ratios could meet this need in most instances.

Industry professionals we have contacted suggested additional investment-specific needs might easily be disclosed as well, including sales charges, surrender charges, wrap fees, things of that nature. Some also suggest that participants receive information on returns net of fees to encourage the participant to consider fees in the context of returns rather than just focusing on fee levels alone.

However, as I will note in a moment, when I move to discussing the format for disclosure, keeping it simple is really important if participants are to read and make use of the information provided. Participants are not the only parties who need better information. Plan sponsors would benefit from a broad range of information as they seek to fulfill their roles as fiduciaries.

In addition to information on plan fees, sponsors need information, for example, on service providers' business arrangements and revenue-sharing options to ensure that plans' fees and expenses are reasonable and not affected by conflicts of interest. In our prior work, we also made recommendations to require plan service providers to offer sponsors information of this nature.

Some have also suggested that sponsors and participants may not know how to evaluate fees they are paying absent some sort of benchmark for comparison. Because participants have no control over investment options available to them, benchmarks may be most important for the sponsors, as they make decisions that affect plan costs.

But whether or not benchmarks are provided, a consistent approach to fee and cost disclosure, one that allows comparison across

options within a plan and across plans overall, because people do move around, would benefit both participants and sponsors.

Let me move now to the format in which fee information might be disclosed. In prior work we found that certain practices help people understand complicated information. The use of simple language, straightforward and attractive layout, brevity and multiple means of distribution are all key to documents the general public will obtain, read and comprehend.

Distribution, layout and document length determine whether people will even look at the information. If they can't obtain the disclosure easily, for example if it is provided only electronically and they don't have regular access to a computer, they will almost certainly never read it. Or if it is too long, crammed with text or in tiny, tiny typeface, even if participants receive it, experience with other disclosures suggests they won't read it.

Yet even the most attractively designed document must still be written in accessible and simple language, and provide only the most basic and important information if it is to be read and understood. Clearly, design and means of conveying 401(k) fee information will be crucial to achieving not just disclosure, but also improved participant understanding.

To conclude, 401(k) participants, and even sponsors, need better and more consistent information about plan fees. Focusing on the most basic fee information, providing it in a way that participants will read and understand it, and being consistent in its provision across plans will be key. Providing information of this nature will not only inform plan participants in making retirement, saving and investment decisions, it may also have the salutary effect of sharpening competition and, in the end, reducing fees charged to 401(k) plans.

That concludes my statement, Mr. Chairman. I hope that my full statement can be submitted for the record.

[The prepared statement of Ms. Bovbjerg follows:]

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United States Government Accountability Office

**GAO**

**Testimony**

**Before the Special Committee on Aging,  
U.S. Senate**

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For Release on Delivery  
Expected at 10:30 a.m. EDT  
Wednesday, October 24, 2007

## **PRIVATE PENSIONS**

### **401(k) Plan Participants and Sponsors Need Better Information on Fees**

Statement of Barbara D. Bovbjerg, Director  
Education, Workforce, and Income Security Issues



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GAO-08-95T

October 23, 2007

## PRIVATE PENSIONS

## 401(k) Plan Participants and Sponsors Need Better Information on Fees

GAO  
Accountability through Integrity

# Highlights

Highlights of GAO-08-95T, a testimony before the Senate Special Committee on Aging

## Why GAO Did This Study

According to Labor's most recent data, there are an estimated 44 million active participants in 401(k) plans. As participants accrue earnings on their investments, they also pay a number of fees associated with 401(k) plans. Over the course of the employee's career, fees may significantly decrease retirement account balances. For plan sponsors, understanding the fees they are being charged helps fulfill their fiduciary responsibility to act in the best interest of plan participants.

GAO's prior work on 401(k) fees found that fee disclosures are limited and do not allow an easy comparison of investment options. GAO previously made recommendations to both Congress and Labor on ways to improve the disclosure of fee information to both plan participants and sponsors. Both Labor and Congress now have efforts under way to ensure that both participants and sponsors receive the necessary fee information to make informed decisions. These efforts on the subject have generated significant debate. This testimony provides information about the way fee information could be disclosed to benefit 401(k) participants and sponsors, focusing on 1) the information on fees that could be most useful for plan participants and plan sponsors and 2) how such information could be effectively presented. To complete this statement, GAO relied on previous work and also utilized information from Labor and from industry experts on the subject of fee disclosure to participants.

To view the full product, including the scope and methodology, click on GAO-08-95T. For more information, contact Barbara D. Bovbjerg at (202) 512-7215 or [bovbjergb@gao.gov](mailto:bovbjergb@gao.gov).

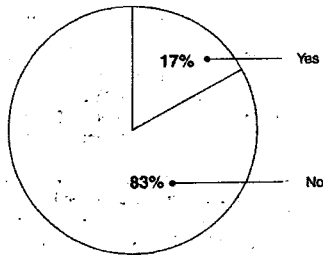
## What GAO Found

Fee disclosure serves different functions for plan participants and sponsors. Studies have shown that 401(k) participants often lack basic knowledge about the fees associated with their plan. Participants need information about the direct expenses that could be charged to their accounts. As we previously recommended and most experts agree, the expense ratio—a fund's operating fees as a percentage of its assets—is a fundamental piece of information for participants. Plan sponsors, in contrast, need a range of fee information to fulfill their fiduciary responsibilities. Sponsors need additional information on service providers, investment options, and revenue sharing arrangements to assist them in monitoring plan fees and determining whether they continue to be reasonable in light of the services provided. Labor has ongoing efforts designed to help participants and plan sponsors understand the importance of plan fees and the effect of those fees on retirement savings.

Whether participants receive only basic expense ratio information or more detailed information on fees, presenting the information in a clear, easily comparable format can help participants understand the content of the disclosure. GAO's prior reports found that certain practices help people understand complicated information. For example, using clear language and a straightforward layout in a brief document can enhance the accessibility of financial information. Also, providing graphics and less text can both attract recipient attention and make detailed information more quickly and easily understandable.

### Participants' Response to Survey Question on Awareness of Fees

Do you know how much in fees and expenses you are paying for your 401(k) plan?



Source: AARP's Survey of 401(k) Participants' Awareness and Understanding of Fees, July 2007.

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Mr. Chairman and Members of the Committee:

I am pleased to be here to discuss how best to disclose fee information to 401(k) participants and plan sponsors. Fees can significantly decrease participants' retirement savings over the course of a career. For 401(k) participants, even a small fee deducted from a worker's assets today could represent a large amount of money years later had it remained in the account to be reinvested. For plan sponsors, understanding the fees being charged helps fulfill their fiduciary responsibility to act in the best interest of plan participants.

Given that fees can have a large impact on an individual's account balance over time, it is important that both participants, as investors, and plan sponsors, typically the employer, receive the fee information necessary to make informed decisions. The Department of Labor (Labor) is currently drafting regulations on the disclosure of fees to participants, and Congress is now considering legislation to improve such disclosure. These efforts have generated debate about the type of fee information participants and sponsors may need, and the amount and format of fee information that should be disclosed. As Congress considers these issues, you asked us to provide information about the way fees could be disclosed to benefit 401(k) participants and sponsors. My remarks today will focus on 1) the information on fees that could be most useful for plan participants and sponsors and 2) how such information can be presented to participants so that it is easily understandable.

To describe the fee information that should be provided to 401(k) plan participants and sponsors, we relied on our previous work that examined the types of fees associated with 401(k) plans and who pays these fees, how information is disclosed to participants, and Labor's oversight of fees. We also used information from Labor and from industry experts on the subject of fee disclosure to participants. To consider how such fee information should be provided to participants, we reviewed our previous work on the understandability of Social Security and other disclosures, and utilized available industry information on the subject. We conducted our review from September 2007 through October 2007 in accordance with generally accepted government auditing standards.

In summary, fee disclosure serves different functions for plan participants and sponsors. Participants need information about the direct expenses that could be charged to their accounts. As we previously recommended and most experts agree, the expense ratio—a fund's operating fees as a percentage of its assets—is a fundamental piece of information for plan

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participants. Some experts also recommend that other types of fees be disclosed, such as certain types of annual fees, and fees that are not necessarily investment-specific. Plan sponsors, in contrast, need a range of fee information to fulfill their fiduciary responsibilities. Thus, sponsors need additional information on service providers, investment options, and revenue sharing arrangements to fulfill their duties as fiduciaries. Such information assists them in monitoring plan fees and determining whether the fees charged continue to be reasonable in light of the services provided. Labor is currently considering what fee information should be provided to participants and what format to enable participants to easily compare fees across a plan's various investment options. The agency also has ongoing efforts designed to help participants and sponsors understand the importance of plan fees and the effect of those fees on retirement savings.

Whether participants receive only basic expense ratio information or more detailed information on various fees, presenting the information in a clear, easily comparable format can help participants understand the content of the disclosure. The language, layout, length, comparability, and distribution are among the important considerations that can inform the design of fee disclosure. In our prior reports on helping the public understand Social Security publications and on more effective disclosures for credit cards, we found that certain practices help people understand complicated information. For example, using clear language and a straightforward layout in a brief document can enhance the accessibility of financial information. Further, providing graphics and less text can both attract recipient attention and make detailed information more quickly and easily understandable.

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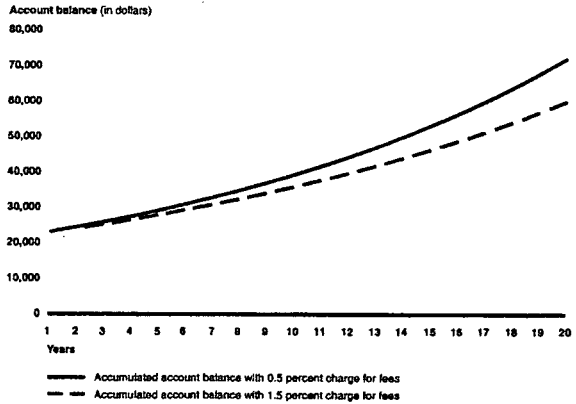
## Background

According to Labor's most recent data, an estimated 41 million participants in 401(k) plans are permitted to direct the investment of all or a portion of their plans' accounts from among the choices offered by their plans. As participants accrue earnings on their investments, they also pay a number of fees, covering expenses, commissions, or other charges associated with 401(k) plans. Over the course of the employee's career, fees may significantly decrease retirement account balances. For example, even a 1-percentage point difference in fees can significantly reduce the amount of money available for retirement. Figure 1 assumes an employee of 45 years of age with 20 years until retirement changes employers and leaves \$20,000 in a 401(k) account until retirement. If the average annual net return is 6.5 percent—a 7 percent investment return minus a 0.5 percent charge for fees—the \$20,000 will grow to about \$70,500 at



retirement. However, if fees are instead 1.5 percent annually, the average net return is reduced to 5.5 percent, and the \$20,000 will grow to only about \$58,400. The additional 1 percent annual charge for fees would reduce the account balance at retirement by about 17 percent.

**Figure 1: Effect of 1 Percentage Point in Higher Annual Fees on a \$20,000 401(k) Balance Invested over 20 Years**

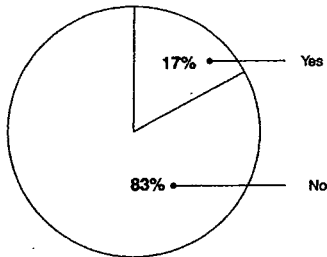


Currently, most participants are responsible for directing their investments among the choices offered by their 401(k) plans, but may not be aware of the different fees that they pay. According to industry professionals, participants are often unaware that they pay any fees associated with their 401(k) plan. In fact, studies have shown that 401(k) participants often lack basic knowledge about the fees associated with their plan. As shown in figure 2, in a recent nationwide survey, 83 percent of 401(k) participants reported not knowing how much they pay in fees. When asked whether they pay any fees for the 401(k) plan, less than one-fifth (17%) said they do pay fees. As figure 3 shows, almost two-thirds

responded that they do not pay fees (66%) and 18% stated that they do not know.<sup>1</sup>

**Figure 2: Participants' Response to Survey Question on Awareness of Fees**

**Do you know how much in fees and expenses you are paying for your 401(k) plan?**

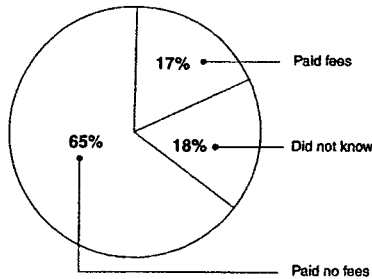


Source: AARP's Survey of 401(k) Participants' Awareness and Understanding of Fees, July 2007.

<sup>1</sup> AARP Knowledge Management, *401(k) Participants' Awareness and Understanding of Fees*, (Washington, D.C.; July 2007). AARP commissioned a nationally representative survey of 1,584 401(k) plan participants ages 25 and older. The survey was fielded from June 8th through June 24th, 2007 by Knowledge Networks of Menlo Park, California, to members of its nationally representative online panel. The overall sample was designed to be nationally representative of 401(k) plan participants age 25 and older.

**Figure 3: Participants' Response to Survey Question on Awareness of Fees**

**Do you know whether you pay any fees for your 401(k) plan?**



Source: AARP's Survey of 401(k) Participants' Awareness and Understanding of Fees, July 2007.

Industry professionals agree that making participants who direct their investments more aware of fees would help them make more informed investment decisions.

Enacted before these types of plans came into wide use, the Employee Retirement Income Security Act (ERISA) of 1974<sup>3</sup> establishes the responsibilities of employee benefit plan decision makers and the requirements for disclosing and reporting plan fees. Typically, the plan sponsor is a fiduciary.<sup>4</sup> A plan fiduciary includes a person who has discretionary authority or control over plan management or any authority or control over the management or disposition of plan assets.<sup>4</sup> ERISA requires that plan sponsors responsible for managing employee benefit plans carry out their plan responsibilities prudently and solely in the interest of the plan's participants and beneficiaries. Plan sponsors, as

<sup>3</sup> 29 U.S.C. §§ 1001-1461.

<sup>4</sup> Any person who makes investment decisions with respect to a qualified employee benefit plan's assets is generally a fiduciary. The duties the person performs for the plan rather than their title or office determines whether that person is a plan fiduciary. 29 U.S.C. § 1002(21)(A).

<sup>4</sup> 29 U.S.C. § 1002(21).

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fiduciaries, are required to act on behalf of plan participants and their beneficiaries. These responsibilities include

- selecting and monitoring service providers to the plan;
- reporting plan information to the government and to participants;
- adhering to the plan's investment policy statement and other plan documents (unless inconsistent with ERISA);
- identifying parties-in-interest to the plan and taking steps to monitor transactions with them;
- selecting investment options the plan will offer and diversifying plan investments; and
- ensuring that the services provided to their plan are necessary and that the cost of those services is reasonable.

In our November 2006 report on 401(k) fees, we found that the fee information that ERISA requires 401(k) plan sponsors to disclose is limited and does not provide participants with an easy way to compare investment options.<sup>6</sup> All 401(k) plans are required to provide disclosures on plan operations, participant accounts, and the plan's financial status. Although they often contain some information on fees, these documents are not required to disclose the fees borne by individual participants. Overall, we found that the information currently provided to participants does not provide a simple way for them to compare plan investment options and their fees, and are provided to participants in a piecemeal fashion.

Additional fee disclosures are required for certain—but not all—plans in which participants direct their investments. ERISA requires disclosure of fee information to participants where plan sponsors seek liability protection from investment losses resulting from participants' investment decisions. Such plans—known as 404(c) plans—are required to provide participants with a broad range of investment alternatives, descriptions of the risks and historical performance of such investment alternatives, and information about any transaction fees and expenses in connection with

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<sup>6</sup> GAO, *Private Pensions: Changes Needed To Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees*, GAO-07-21 (Washington, D.C.: November 16, 2006).

buying or selling interests in such alternatives.<sup>4</sup> Upon request, 404(c) plans must also provide participants with, among other information, the expense ratio for each investment option. Plan sponsors may voluntarily provide participants with more information on fees than ERISA requires, according to plan practitioners. For example, plan sponsors that do not elect to be 404(c) often distribute prospectuses or fund profiles when employees become eligible for the plan, just as 404(c) sponsors do. Still, absent requirements to do so, some plan sponsors may not identify all the fees participants pay.

Some participants may be able to make comparisons across investment options by piecing together the fees that they pay, but doing so requires an awareness of fees that most participants do not have. Assessing fees across investment options can be difficult for participants because the data are typically not presented in a single document which facilitates comparison. However, most 401(k) investment options have expense ratios that can be compared; according to industry data, the majority of 401(k) assets are in investment options, such as mutual funds that are generally required to present the expense ratio in a prospectus.

Plan sponsors, on the other hand, may currently receive some information on an investment option's expenses that includes management fees, distribution and/or service fees, and certain other fees, such as accounting and legal fees. These fees are usually disclosed in the fund's prospectus or fund profile. In addition to investment fees, sponsors may receive information about fees for administration and other aspects of plan operations. Sponsors can also have providers fill out the Form 5500, which ultimately gets filed with Labor.<sup>7</sup> Generally, information on 401(k) fees is

<sup>4</sup> ERISA Section 404(c) generally provides relief for plan fiduciaries of certain individual account plans, such as 401(k) plans, from liability for losses resulting from investment decisions made by plan participants and beneficiaries. 29 U.S.C. § 1104(c). Implementing regulations provide specifics for complying with section 404(c). 29 C.F.R. § 2550.404c-1 (2007).

<sup>7</sup> The Form 5500 includes information on the plan's sponsor, the features of the plan, and the number of participants. The form also provides more specific information, such as plan assets, liabilities, insurance, and financial transactions. Filing this form satisfies the requirement for the plan administrator to file annual reports concerning, among other things, the financial condition and operation of plans. Labor uses this form as a tool to monitor and enforce plan sponsors' responsibilities under ERISA.

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reported on two sections of the Form 5500, Schedule A and Schedule C.<sup>8</sup> However, our November 2006 report stated that the form is of little use to plan sponsors and others in terms of understanding the cost of a plan.<sup>9</sup>

While plan sponsors may receive information on investment and other fees, they may not be receiving information on certain undisclosed business arrangements. We previously reported that several opportunities exist for business arrangements to go undisclosed, given the various parties involved in creating and administering 401(k) plans. Problems may occur when pension consultants or other companies providing services to a plan also receive compensation from other service providers. Without disclosing these arrangements, service providers may be steering plan sponsors toward investment products or services that may not be in the best interest of participants. In addition, plan sponsors, being unaware, are often unable to report information about these arrangements to Labor on Form 5500 Schedule C. Our November 2006 report recommended that Congress consider amending ERISA to require that service providers disclose to plan sponsors the compensation that providers receive from other service providers.

H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007, was introduced in Congress on July 26, 2007, and H.R. 3765, the Defined Contribution Plan Fee Transparency Act of 2007, was introduced on October 4, 2007. The first bill if enacted would, among other things, amend ERISA to require detailed fee disclosures from service providers to plan sponsors, as well as from plans to participants, and establish additional specific requirements related to the selection of investment options by 404(c) plan sponsors. It would also require Labor to take various steps related to the enforcement of these requirements and would create statutory penalties for failure to comply. The second bill would amend the Internal Revenue Code to impose taxes on any defined contribution plan

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<sup>8</sup> Schedule A is used to report fees and commissions paid to brokers and sales agents for selling insurance products. Schedule C includes information on the fees paid directly to service providers for all other investment products, but excludes investment fees deducted from returns. Schedule C also identifies service providers with fees in excess of \$5,000 by name.

<sup>9</sup> Labor's ERISA Advisory Council Working Group on Plan Fees and Reporting on Form 5500 came to this conclusion, stating that only the fees that are billed explicitly and are paid from plan assets are deemed reportable. Many of the fees are associated with the individual investment options in the 401(k) plan, such as a mutual fund, and are deducted from investment returns and not reported to plan sponsors or on the Form 5500.

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administrator failing to provide plan participants with prescribed information about plan fees and expenses, and on any plan service provider failing to provide defined contribution plan administrators prescribed information about plan fees and expenses. Both bills suggest that a satisfactory disclosure to participants would include a statement explaining that investments should not be selected based solely on the level of fees charged but also on careful consideration of a range of factors including the alternatives' risk level, historic returns, and investment objectives.

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### **Basic Fee Information is Important for Participants to make Informed Decisions but Plan Sponsors Require Broader Information**

Fee disclosure serves different functions for plan sponsors and participants. Participants need fee information to make informed decisions about their investments—primarily, whether to contribute to the plan (and at what level) and how to allocate their contributions among the investment options the plan sponsor has selected. As we previously recommended and most experts agree, the expense ratio is a fundamental piece of information for plan participants. Plan sponsors, as fiduciaries, must consider a range of information, in addition to information on fees, such as hiring and supervising plan service providers, selecting investment options, and reviewing the reasonableness of plan fees.

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### **Participants Need Fee Information to Make Informed Comparisons and Decisions about How to Direct their Investments**

Although it is clear that participants require fee information to make informed decisions, it is not so clear what fee information is most relevant. Better disclosure of fee information is important because participants in 401(k) plans generally receive less information and guidance from investment professionals regarding their investment decisions than direct investors. According to industry experts, participants need to be given information about the direct expenses that could be charged to their accounts.

In our 2006 report on fees, we found that fees are charged by the various outside companies that the plan sponsor hires to provide a number of services necessary to operate a plan. Services can include

- investment management (i.e., selecting and managing the securities included in a mutual fund; marketing the fund and compensating

brokers who sell the fund;<sup>10</sup> and providing other shareholder services, such as distributing the fund prospectus);<sup>11</sup>

- recordkeeping (i.e., tracking individual account contributions);
- consulting and providing financial advice (i.e., selecting vendors for investment options or other services);
- custodial or trustee services for plan assets (i.e. holding the plan assets in a bank); and
- telephone or Web-based customer services for participants.

In our report, we recommended that Congress consider amending ERISA to require all sponsors of participant-directed plans to disclose fee information on 401(k) investment options to participants in a way that facilitates comparison among the options, such as via expense ratios.<sup>12</sup> As mentioned earlier, there have been two bills recently introduced in Congress on the subject. Industry professionals have also suggested that comparing the expense ratio across investment options is the most effective way to compare options' fees. They generally agree that an expense ratio provides valuable information that participants need and can be used to compare investment options because it includes investment fees, which constitute most of the total fees borne by participants. According to an industry official, the disclosure of expense ratios might include a general description of how expense ratios vary depending on the type and style of investment. For example, investment options with relatively high fees, such as actively managed funds, tend to have larger expense ratios than funds that are not actively managed. Also, investment options that are only available to institutional investors tend to have lower expense ratios than other types of funds.

Most of the investment options offered in 401(k) plans have expense ratios that can be compared, but this information is not always provided to participants. In addition, investment options other than mutual funds may

<sup>10</sup> Fees related to marketing and compensating brokers to sell the fund are known as 12b-1, or distribution fees, and are limited by the Financial Industry Regulatory Authority, the entity that succeeded the National Association of Securities Dealers Inc., to a maximum of 1-percentage point of the total expense ratio per year.

<sup>11</sup> Investment fees are usually different for each investment option available to participants in a 401(k) plan, account for the bulk of plan fees, and are paid by participants.

<sup>12</sup> We found that it is hard for participants to make comparisons across investment options because they have to piece together the fees that they pay, and assessing fees across investment options can be difficult because data are not typically presented in a single document that facilitates comparison.



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not be required to produce prospectuses that include expense ratios, but according to industry professionals, such options have expense ratio equivalents that investment industry professionals can identify. Despite the general consensus that the expense ratio is the most fundamental piece of information that participants receive on fees, industry officials also believe that other fees should be disclosed to participants. For example, annual fees or fees on a per-transaction basis could be disclosed, such as administrative and recordkeeping fees, participant loan origination fees, and annual loan charges.<sup>13</sup>

In addition, industry professionals also recommended that additional investment-specific fees be disclosed, including

- redemption fees or sales charges—fees that may be imposed by the provider as a result of changing investments in a given period;
- surrender charges—fees that may be imposed as a result of selling or withdrawing money from the investment within a given number of years after investing; and
- wrap fees—fees that are assessed on the total assets in a participant's account.<sup>14</sup>

Industry experts said that it was important that participants receive information about their investment returns. For example, some officials recommended that plan participants be provided information on their returns net of all fees so that they can clearly see what their investments have earned after fees. Others recommended that information be disclosed that explains how the investment and administrative costs of the plan affect their investment returns and their overall retirement savings in the plan. These officials believed that such information would help participants understand that fees are an important factor, but not the only one, to consider when directing their investments. In fact, most experts

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<sup>13</sup> Plan record-keeping fees cover individual account maintenance for plan participants. They cover a variety of activities, such as enrolling participants, processing fund selections, preparing and mailing account statements, and other related administration activities. A loan origination fee is charged to a participant who elects to take a loan from the plan. The fee covers document preparation and loan processing expenses. Annual loan charges are imposed for account maintenance.

<sup>14</sup> Wrap fees are for various expenses, such as sales commissions, administrative expenses, and/or recordkeeping fees. However, wrap fees can also be assessed against specific investment options and/or at the plan level based on total plan assets. For example, a wrap fee may be assessed against a "low fee" investment option because the investment provider does not contribute toward the cost of plan recordkeeping and administration.

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agree that risk and historical performance are important factors for participants to also consider when making investment decisions.

Although some industry experts believe that participants should be provided comparative benchmarks for their investment options, not all experts agreed.<sup>14</sup> Most industry experts we consulted believed that benchmarks would be more useful for plan sponsors. Since plan participants do not have any control over the investment options offered in a plan, experts said that benchmarking is less useful to plan participants than plan sponsors, since plan sponsors use benchmarks in evaluating alternatives to their plans' investment options. Experts also noted that although there are appropriate benchmarks for mutual funds, benchmarks are not as readily available for other types of investment products.

Industry experts agreed that overall there is certain minimum information that participants should receive for each investment option offered under all self-directed plans, such as 1) the types of securities held and investment objectives of the product; 2) the principal risks associated with investing in the product; 3) annual fees and expenses expressed in a ratio or fee table; 4) information on historical performance; and 5) the identity of the investment manager of the plan's investments. Disclosure of this information is appropriate for all types of investment options available under the plan regardless of type and can fill in the gaps in the information currently required to be provided to participants. For example, with the exception of mutual funds, for most other types of investment products, important information—such as operating expenses and historical performance—is available only on request. Industry experts support requiring the provision of a summary document for all self-directed plans that provides, for each investment product, the type of information that investors value and use.

#### Labor's initiatives related to 401(k) plan participants

In our prior work, we noted that Labor is considering the development of a new rule regarding the fee information required to be furnished to participants under its section 404(c) regulation. According to Labor officials, they are attempting to identify the critical information on fees that plan sponsors should disclose to participants and the best way to do so. The initiative is intended to explore what steps might be taken to

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<sup>14</sup> A benchmark is used to compare specific investment results with that of the market or economy. Some industry experts believe that plan sponsors, as they monitor investment alternatives, should review investment-alternative results against appropriate benchmarks and compare their plans' investment options to competing funds with similar styles.

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ensure that participants have the information they need about their plan and available investment options, without imposing additional costs, given that such costs are likely to be charged against the individual accounts of participants and affect their retirement savings. The officials are currently considering what fee information should be provided to participants and what format would enable participants to easily compare the fees across a plan's various investment options. Labor is also currently evaluating comments received from consumer groups, plan sponsors, service providers, and others as it develops its proposed regulation.

Labor also has ongoing efforts designed to help participants and plan sponsors understand the importance of plan fees and the effect of those fees on retirement savings. Labor has developed and makes available on its Web site, a variety of educational materials specifically designed to help plan participants understand the complexities of the various fee and compensation arrangements involved in 401(k) plans. Its brochure titled *Look at 401(k) Plan Fees* is targeted to participants and beneficiaries of 401(k) plans who are responsible for directing their own investments.

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#### **Broader Information Can Help Plan Sponsors Fulfill Their Fiduciary Responsibilities**

Although participants' fee requirements are more specific to the investment options offered to them by the plan sponsor, a broader spectrum of information relating to fees is needed by plan sponsors. In order to carry out their duties, plan sponsors have an obligation under ERISA to prudently select and monitor plan investments, investment options made available to the plan's participants and beneficiaries, and the persons providing services to the plan. Understanding and evaluating the fees and expenses associated with a plan's investments and services are an important part of a fiduciary's responsibility. Plan sponsors continually need, in addition to information on fees, information on service providers, investment options, and revenue sharing arrangements in order to monitor a plan's fees and expenses to determine whether they continue to be reasonable for the services provided.

Industry experts have suggested that plan sponsors be required to obtain complete information about investment options before adding them to the plan's menu and obtain information concerning arrangements where a service provider receives some share of its revenue from a third party. A number of associations recently put together a list of service- and fee-related data elements they believe defined contribution plan sponsors and service providers should discuss when entering into agreements. The data elements include such information as payments received by plan service providers from affiliates in connection with services to the plan, float

revenue," and investment-related consulting services. The list is meant as a reference tool for plan sponsors and providers to use to determine the extent to which a service provider receives compensation in connection with its services to the plan from other service providers or plan investment products (e.g., "revenue sharing" or "finders' fees"). According to the associations that formulated this tool, the information can aid plan sponsors to evaluate any potential conflicts of interest that may arise in how fees are allocated among service providers.

Labor, in its comments to our November 2006 report, stated that the agency has proposed a number of changes to the Form 5500, including changes that would expand the information required to be reported on the Schedule C. The changes are intended to assist plan sponsors in assessing the reasonableness of compensation paid for services and potential conflicts of interest that might affect those services. According to testimony earlier this month from the Assistant Secretary of Labor, the agency will be issuing a final regulation requiring additional public disclosure of fee and expense information on the Form 5500 within the next few weeks.<sup>16</sup> This change will be helpful to plan sponsors as they look retrospectively at the preceding plan year. In addition, Labor was considering an amendment to its regulation under section 408(b)(2) of ERISA, expected to be issued this year. This amendment would help to ensure that plan sponsors have sufficient information on the compensation to be paid to the service provider and the revenue sharing compensation paid by the plan for the specific services and potential conflicts of interest that may exist on the part of the service provider.

Labor's ERISA Advisory Council currently has a working group focusing on fiduciary responsibility and revenue sharing. One area of focus is what service providers should be required to provide when they enter into a revenue sharing or rebate arrangement. Labor also provides a model form on its Web site specifically designed to assist plan fiduciaries and service providers in exchanging complete disclosures concerning the costs involved in service arrangements. Other associations and entities continue to develop model fee-disclosure forms for plan sponsors.

<sup>16</sup> Floated revenue is revenue earned from the short-term investment of plan assets.

<sup>17</sup> Statement of Bradford P. Campbell, Assistant Secretary of Labor, Before the Committee on Education and Labor, U.S. House of Representatives, Oct. 4, 2007.

We are currently conducting work in the area of 401(k) plan sponsor practices, identifying how plan sponsors decide which features to include in the plans they establish and how plan sponsors oversee plan operations. Part of our work will consider how plan sponsors monitor the fees charged to their plans. We expect to issue a report in 2008.

## Making Fee Information Easy to Understand and Compare Can Help 401(k) Participants with Disclosed Information

Whether participants are provided with basic expense ratio information or more detailed information on various fees, or both, providing the information in a clear, easily comparable format can assist participants in understanding the information disclosed. In our prior reports on helping the public understand Social Security information and on more effective disclosures for credit cards, we found that certain practices help people understand complicated information.<sup>18</sup> These practices include

- language—writing information in clear language;
- lay-out—using straightforward layout and graphics;
- length—providing a short document;
- comparability—making options easy to compare in a single document; and
- distribution—offering a choice of paper or electronic distribution.

**Language:** We previously noted that certain disclosure materials for the public should be written at or below an eighth-grade reading level given the diverse population receiving it. Unclear or highly technical language can affect the understandability of disclosures to participants. Plain English can reduce confusion and promote comprehension. Currently, according to one industry expert, prospectuses do not provide an understandable summary of investments or their expenses to participants since prospectuses are largely written to protect the fund. As disclosures address fees beyond the expense ratio, clear language remains important so that participants understand what key fees mean and when they apply.

<sup>18</sup> GAO, *Social Security Statements: Social Security Administration Should Better Evaluate Whether Workers Understand Their Statements*, GAO-06-192 (Washington, D.C.: Apr. 1, 2006); GAO, *Social Security Administration: Longstanding Problems in SSA's Letters to the Public Need to Be Fixed*, GAO/HEHS-00-179 (Washington, D.C.: Sept. 28, 2000); GAO, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, GAO-06-929 (Washington, D.C.: Sept. 12, 2006); and GAO, *SSA Benefit Statements: Well Received by the Public but Difficult to Comprehend*, GAO/HEHS-07-19 (Washington, D.C.: Dec. 5, 1996).

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*Layout:* Some consumer and industry groups emphasized the need for a straightforward layout. In response to Labor's Request For Information on fee disclosure to participants,<sup>19</sup> one industry group stated that disclosure with a simple format may lead some participants to consider fees as one of many factors in their investment decisions. The group added that complex language or layout hinders meaningful disclosure. Similarly, in our previous work on Social Security disclosures, we noted that the design of certain disclosures did not clearly identify the most important information or easily lead the reader through the document. For example, letters and statements to beneficiaries were harder to follow when the order of information did not flow logically or the most important information did not appear first in the document. Another aspect of layout—the use of inappropriate font sizes and styles—can make a disclosure more difficult for consumers to read, as we found in our prior work on credit card fee disclosures. For example, materials that excessively use capital letters or a small font may be more difficult to read.

Our prior work also revealed that using graphics helps people understand complicated information or information that needs to be compared. Table 1 shows an example of how industry associations suggest that the expense ratio and other fee information could be disclosed to plan participants. Using a table can be a particularly effective way to convey information. In a previous report, we noted that using graphics to replace text and make some information more quickly and easily understandable was a common theme that emerged in the suggestions made by focus groups and a benefits consulting firm.

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<sup>19</sup> 72 Fed. Reg. 20,457 (Apr. 25, 2007).

Table 1: Sample Participant Fee Disclosure Form

Investment expenses			
Investment option	Participant's assets	Expense ratio (as a percentage)	Additional fees
AAA investment	\$5,000	0.30%	0.00%
BBB investment	\$6,000	0.22%	0.00%
CCC investment	\$12,000	0.36%	2.00%
DDD investment	\$0	0.43%	1.50%
EEE investment	\$0	0.27%	0.00%
FFF investment	\$42,000	0.18%	0.00%
GGG investment	\$3,000	0.60%	1.00%
Administrative and transactional expenses			
Service	Amount of fee		
Annual administrative and recordkeeping charge	\$50 per year		
Brokerage account	\$80 per year		
Participant loan origination fee	\$50 per loan		
Annual loan charge	\$25 per year		

Source: Industry associations, including the American Society of Pension Professionals & Actuaries and the Council of Independent 401(k) Recordkeepers.

**Length:** In addition to clear language and layout, the length of the document can influence how useful it is for participants. Some groups have concerns that too much information can overwhelm participants. For participant-directed plans, a few studies have shown that more investment options are correlated with reduced participation or other outcomes, possibly because of too many choices or information overload. Shorter disclosures are emerging for a number of vehicles for retirement savings. For example, the Securities and Exchange Commission (SEC) is currently considering rules to develop a streamlined prospectus. This affects the presentation of information about mutual funds, which constitute over half of 401(k) assets according to industry data. Omitting unnecessary details from disclosure documents makes recipients more likely to read and understand information they contain.

Clear, short annual disclosures do not preclude making additional information available, especially when using an electronic format. With 401(k) plans, the availability of additional material permits participants to review greater detail about fees and other fund characteristics through documents like a prospectus or fund profile. These additional sources can be paper or electronic, and industry groups noted that an electronic

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format can allow layered disclosure with initial summary information and links to further material or source documents. In addition, providing ways for participants to obtain more detailed information is helpful. For example, experts we consulted during our work on the Social Security Statements<sup>28</sup> advised that statements should contain directions on how to obtain additional information.

*Comparability:* Our November 2006 report on 401(k) fees emphasized the importance of a single document that facilitates the comparison of fund options. In their responses to Labor's Request for Information, industry groups recently reiterated the importance of disclosures that promote comparisons, which would assist participants and treat providers of different types of investments evenly. As we recommended to Congress, disclosure in a single document that includes expense ratios should occur in a way that promotes easy comparison. Similarly, additional fees like redemption fees or surrender charges that may relate to certain investment options can also be compared in one document enabling participants to know what fees they may incur for activities like buying and selling in certain funds. Disclosures in multiple documents may be more difficult for the reader to use because they may require more work to find information, especially when delivered over time.

*Distribution:* Possible ways to deliver 401(k) fee disclosure include both paper and electronic distribution. Paper reports, such as summary plan descriptions, prospectuses for mutual funds, and other documents, traditionally have been used to provide pension and fee information. Not all participants have computer or internet access, and many may prefer paper disclosure, as indicated by a recent nationwide survey about 401(k) fee disclosure. Although paper disclosure rather than electronic delivery may suit certain participants, many industry groups place emphasis on computer-based formats, partly to lower costs like printing and mailing and to allow layered disclosure by clicking to more detailed information or source documents. One industry association commented that Internet-based information is easier to maintain and update so that it tends to be more timely and accurate.

Recent pension legislation has discussed electronic disclosure in some circumstances. The Pension Protection Act of 2006 allows paper, electronic, or other formats for benefit statements to the extent that the

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<sup>28</sup> GAO-05-192.



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format is reasonably accessible to the participant or beneficiary.<sup>21</sup> In guidance about benefit statements issued in 2006, Labor stated that continuous access to one or more secured Web sites is one way of providing information as long as, among other things, notification about the sites includes the right to request and obtain free paper versions. In addition, Labor has issued a regulation for the general use of electronic disclosure to participants and beneficiaries.<sup>22</sup> Also, SEC has recently adopted and proposed rules with increased electronic disclosure, partly to reduce costs, which allow for paper disclosure as well as electronic delivery.<sup>23</sup>

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## Conclusions

It is apparent that both 401(k) plan participants and sponsors need fee information in order to make the most informed decisions. However, given the voluminous amount of information that could be disclosed to participants, determining the relevant information that participants most need is key. At a minimum, providing information such as expense ratios or other investment-specific fee information could be the place to start. Also, making sure that the information is accessible in terms of the language, layout, length, comparability, and distribution can ensure that participants actively utilize the information disclosed. As participants become more sophisticated or demand more information, decisions can then be made about the type and format of additional fee information.

For plan sponsors, requiring that certain information on fees be disclosed can help them understand what services they are paying for, who is benefiting, and whether their current arrangements are in the best interest of plan participants. The mere act of requiring such information may actually promote competition among the entities that provide services to plans and possibly reduce the amount of fees service providers charge.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

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<sup>21</sup> Pub. L. No. 109-280, § 608(a), 120 Stat. 780, 949-51 (codified at 29 U.S.C. § 1025).

<sup>22</sup> 29 C.F.R. § 2520.104b-1(c) (2007).

<sup>23</sup> 72 Fed. Reg. 42,222 (Aug. 1, 2007).

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## Contacts and Acknowledgements

For further information regarding this testimony, please contact Barbara D. Bovbjerg, Director, Education, Workforce, and Income Security Issues at (202) 512-7215 or [bovbjergb@gao.gov](mailto:bovbjergb@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Tamara E. Cross, Assistant Director, Monika R. Gomez, Matthew J. Saradjian, Daniel F. Alspaugh, Susannah L. Compton, Craig H. Winslow, and Walter K. Vance.

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The CHAIRMAN. We will do that. Thank you, Ms. Bovbjerg.  
Mr. Campbell.

**STATEMENT OF THE HONORABLE BRADFORD CAMPBELL, ASSISTANT SECRETARY OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, WASHINGTON, DC**

Mr. CAMPBELL. Yes, Mr. Chairman, Senator Smith and the other members of the Committee. I want to very much thank you for the opportunity to testify today about the significant progress we have made at the Department of Labor in promulgating regulations to improve the disclosure of fee, expense, and conflict of interest information in 401(k) and other employee benefit plans. Our regulatory initiatives in this area are a top priority for the Department of Labor.

Over the past 20 years, the retirement plan universe has undergone some significant changes that affect both the workers and plan fiduciaries. More workers now control the investment of their retirement savings in participant-directed individual account plans such as 401(k) plans. At the same time, the financial services marketplace has increased in complexity.

Plan fiduciaries who are charged by law with the responsibility of making prudent decisions when hiring service providers and paying only reasonable expenses have found their jobs more difficult as the number and type of fees proliferate, and as the relationships between financial service providers become more complex.

These trends have caused the department to conclude that, despite the success of our fiduciary and participant education efforts, that a new regulatory framework is necessary to better protect the interests of America's workers, retirees and their families. That is why we initiated three major regulatory projects, each of which address a different aspect of this problem.

The first regulation addresses the needs of participants for concise, useful, comparative information about their plan's investment options. The second regulation addresses the needs of plan fiduciaries, who require more comprehensive disclosures by service providers to enable them to carry out their duties to prudently select those service providers, and understand the nature of the fees and expenses charged for services that are being provided under those contracts. The third regulation addresses disclosures by plan administrators to the public and the government via the Form 5500, which is the Annual Report filed by pension plans.

It is essential to understand that the disclosure needs of each of these groups is different, and that, therefore, the disclosures that we are going to require via our regulations are also different. Participants are choosing investments from among a defined universe of options. To do this, they need concise summary information that allows them to compare these options in meaningful ways that take into account the fees that they are paying, the historical rates of return, the nature of the investment and other factors that are relevant to that determination.

Plan fiduciaries are trying to decide if the services they are contracting for they are receiving, and if the prices they are paying are reasonable and necessary, taking into account the needs of the plan as a whole. Fiduciaries need to know whether the services provided

will be influenced by compensation arrangements between the service providers and third parties, what services are provided, their necessity, and their reasonableness. This process by which plan fiduciaries make prudent decisions necessitates a far more detailed and comprehensive disclosure.

In response to our request for information earlier this year on participant disclosures, it is fairly clear that there is a basic agreement, as Ms. Bovbjerg just also indicated from GAO's perspective, that participants are generally not going to benefit from very lengthy and detailed disclosures in making those investment decisions, because participants are likely to ignore them. Because the participants are also typically bearing the cost of producing these documents, if we produce voluminous disclosures that aren't useful to participants, we could perversely increase the amount of fees participants are paying without providing any additional utility.

It is important to note, I think, that we are not at the beginning of our regulatory initiatives. We are quite well advanced. One of the three projects, the Form 5500 disclosures, will be finalized as a final regulation within the next several weeks, and we have completed drafting our proposed regulation for disclosures by service providers to plan fiduciaries. It is currently under review in the regulatory process and should be promulgated as a proposed regulation within the next several months. We, as I indicated, concluded a request for information on participant disclosures, which we are using to issue a proposed regulation this winter.

I want to commend the Committee for its interest in disclosure in this area. I do want to note that it is important that, should the legislation be pursued, that Congress bear in mind the regulatory process and the progress we have made on our regulations.

I also note that the regulatory process is very well suited to resolving some of these issues that are coming up. A great deal of technical issues are arising in terms of what information should be provided, and how one compares apples to apples across different investment options. As a deliberative, open and inclusive process, the regulatory process has been working well, and we believe will help us resolve these issues in a way that is amenable to the Committee.

So, in conclusion, Mr. Chairman, I want to thank you for your interest in this issue, because it is very important to ensuring the retirement security of America's workers. I am committed to completing our projects in a timely manner, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Campbell follows:]

**WRITTEN TESTIMONY OF BRADFORD P. CAMPBELL  
ASSISTANT SECRETARY OF LABOR  
BEFORE THE  
SPECIAL COMMITTEE ON AGING  
UNITED STATES SENATE**

October 24, 2007

**Introductory Remarks**

Good morning Chairman Kohl, Ranking Member Smith, and Members of the Committee. Thank you for inviting me to discuss 401(k) plan fee disclosure, the Department of Labor's role in overseeing plan fees, and initiatives to increase transparency and disclosure of plan fee and expense information. I am Bradford Campbell, the Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA). I am proud to be here today representing the Department of Labor and EBSA. Our mission is to protect the security of retirement, health and other employee benefits for America's workers, retirees and their families, and to support the growth of our private benefits system.

Ensuring the security of retirement benefits is a core mission of EBSA, and one of this Administration's highest priorities. Excessive fees can undermine retirement security by reducing the accumulation of assets. It is therefore critical that plan participants directing the investment of their contributions, and plan fiduciaries charged with the responsibility of prudently selecting service providers and paying only reasonable fees and expenses, have the information they need to make appropriate decisions.

That is why the Department began a series of regulatory initiatives last year to expand disclosure requirements in three distinct areas:

1. Disclosures by plans to participants to assist in making investment decisions;

2. Disclosures by service providers to plan fiduciaries to assist in assessing the reasonableness of provider compensation and potential conflicts of interest; and
3. More efficient, expanded fee and compensation disclosures to the government and the public through a substantially revised, electronically filed Form 5500 Annual Report.

Each of these projects addresses different disclosure needs, and our regulations will be tailored to ensure that appropriate disclosures are made in a cost effective manner. For example, participants are unlikely to find useful extensive disclosure documents written in "legalese"—instead, it appears from comments we received thus far that participants want concise and readily understandable comparative information about plan costs and their investment options. By contrast, plan fiduciaries want detailed disclosures in order to properly carry out their duties under the law, enabling them to understand the nature of the services being provided, all fees and expenses received for the services, any conflicts of interest on the part of the service provider, and any indirect compensation providers may receive in connection with the plan's business.

We have made significant progress on these projects. We will be issuing a final regulation requiring additional public disclosure of fee and expense information on the Form 5500 within the next few weeks. This year, we also expect to publish a proposed regulation requiring specific and comprehensive disclosures to plan fiduciaries by service providers. We also concluded a Request for Information seeking the views of the interested public on issues surrounding disclosures to participants. We are currently evaluating the comments received from consumer groups, plan sponsors, service providers and others as we develop a proposed regulation. These projects will be explained in detail later in my testimony.

The Employee Retirement Income Security Act of 1974 (ERISA) provides the Secretary of Labor with broad regulatory authority, enabling the Department to pursue these comprehensive disclosure initiatives without need for a statutory amendment. The

regulatory process currently underway ensures that all voices and points of view will be heard and provides an effective means of resolving the many complex and technical issues presented. I hope that as Congress considers this issue, it recognizes the Department's existing statutory authority and takes no action that could disrupt our current efforts to provide these important disclosures to workers. My testimony today will discuss in more detail the Department's activities related to plan fees. Also, I will describe the Department's regulatory and enforcement initiatives focused on improving the transparency of fee and expense information for both plan fiduciaries and participants.

### **Background**

EBSA is responsible for administering and enforcing the fiduciary, reporting, and disclosure provisions of Title I of ERISA. EBSA oversees approximately 683,000 private pension plans, including 419,000 participant-directed individual account plans such as 401(k) plans, and millions of private health and welfare plans that are subject to ERISA.<sup>1</sup> Participant-directed individual account plans under our jurisdiction hold over \$2.2 trillion in assets and cover more than 44.4 million active participants. Since 401(k)-type plans began to proliferate in the early 1980s, the number of employees investing through these types of plans has grown dramatically. The number of active participants has risen almost 500 percent since 1984 and has increased by 11.4 percent since 2000. EBSA employs a comprehensive, integrated approach encompassing programs for enforcement, compliance assistance, interpretive guidance, legislation, and research to protect and advance the retirement security of our nation's workers and retirees.

Title I of ERISA establishes standards of fiduciary conduct for persons who are responsible for the administration and management of benefit plans. It also establishes standards for the reporting of plan related financial and benefit information to the Department, the IRS and the PBGC, and the disclosure of essential plan related information to participants and beneficiaries.

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<sup>1</sup> Based on 2004 filings of the Form 5500.



### **The Fiduciary's Role**

ERISA requires plan fiduciaries to discharge their duties solely in the interest of plan participants and beneficiaries, and for the exclusive purpose of providing benefits and defraying reasonable expenses of plan administration. In discharging their duties, fiduciaries must act prudently and in accordance with the documents governing the plan. If a fiduciary's conduct fails to meet ERISA's standards, the fiduciary is personally liable for plan losses attributable to such failure.

ERISA protects participants and beneficiaries, as well as plan sponsors, by holding plan fiduciaries accountable for prudently selecting plan investments and service providers. In carrying out this responsibility, plan fiduciaries must take into account relevant information relating to the plan, the investment, and the service provider, and are specifically obligated to consider fees and expenses.

ERISA prohibits the payment of fees to service providers unless the services are necessary and provided pursuant to a reasonable contract, and the plan pays no more than reasonable compensation. Thus, plan fiduciaries must ensure that fees paid to service providers and other expenses of the plan are reasonable in light of the level and quality of services provided. Plan fiduciaries must also be able to assess whether revenue sharing or other indirect compensation arrangements create conflicts of interest on the part of the service provider that might affect the quality of the services to be performed. These responsibilities are ongoing. After initially selecting service providers and investments for their plans, fiduciaries are required to monitor plan fees and expenses to determine whether they continue to be reasonable and whether there are conflicts of interest.

### **EBSA's Compliance Assistance Activities**

EBSA assists plan fiduciaries and others in understanding their obligations under ERISA, including the importance of understanding service provider fees and relationships, by

providing interpretive guidance<sup>2</sup> and making related materials available on its Web site. One such publication developed by EBSA is *Understanding Retirement Plan Fees and Expenses*, which provides general information about plan fees and expenses. In conjunction with the Securities and Exchange Commission, we also developed a fact sheet, "Selecting and Monitoring Pension Consultants – Tips for Plan Fiduciaries." This fact sheet contains a set of questions to assist plan fiduciaries in evaluating the objectivity of pension consultant recommendations.

EBSA also has made available on its Web site a model "401(k) Plan Fee Disclosure Form" to assist fiduciaries of individual account pension plans when analyzing and comparing the costs associated with selecting service providers and investment products. This form is the product of a coordinated effort of the American Bankers Association, Investment Company Institute, and the American Council of Life Insurers.

To help educate plan sponsors and fiduciaries about their obligations under ERISA, EBSA conducts numerous educational and outreach activities. Our campaign, "Getting It Right – Know Your Fiduciary Responsibilities," includes nationwide educational seminars to help plan sponsors understand the law. The program focuses on fiduciary obligations, especially related to the importance of selecting plan service providers and the role of fee and compensation considerations in that selection process. EBSA has conducted 21 fiduciary education programs since May 2004 in different cities throughout the United States. EBSA also has conducted 49 health benefits education seminars, covering nearly every state, since 2001. Beginning in February 2005, these seminars added a focus on fiduciary responsibilities. EBSA will continue to provide seminars in additional locations under each program.

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<sup>2</sup> See, e.g., Field Assistance Bulletin 2002-3 (November 5, 2002) and Advisory Opinions 2003-09A (June 25, 2003), 97-16A (May 22, 1997), and 97-15A (May 22, 1997).

**Disclosures to Participants under Current Law**

ERISA currently provides for a number of disclosures aimed at providing participants and beneficiaries information about their plans' investments. For example, information is provided to participants through summary plan descriptions and summary annual reports. Under the Pension Protection Act of 2006, plan administrators are required to automatically furnish pension benefit statements to plan participants and beneficiaries. The Department issued Field Assistance Bulletins in December 2006 and in October 2007 to provide initial guidance on complying with the new statutory requirements. Statements must be furnished at least once each quarter, in the case of individual account plans that permit participants to direct their investments, and at least once each year, in the case of individual account plans that do not permit participants to direct their investments. Other disclosures, such as copies of the plan documents, are available to participants on request.

Additional disclosures may be required by the Department's rules concerning whether a participant has "exercised control" over his or her account. ERISA section 404(c) provides that plan fiduciaries are not liable for investment losses which result from the participant's exercise of control. A number of conditions must be satisfied, including that specified information concerning plan investments must be provided to plan participants. Information fundamental to participants' investment decisions must be furnished automatically. Additional information must be provided on request.

**EBSA Participant Education and Outreach Activities**

EBSA is committed to assisting plan participants and beneficiaries in understanding the importance of plan fees and expenses and the effect of those fees and expenses on retirement savings. EBSA has developed educational brochures and materials available for distribution and through our Web site. EBSA's brochure entitled *A Look at 401(k) Plan Fees for Employees* is targeted to participants and beneficiaries of 401(k) plans who are responsible for directing their own investments. The brochure answers frequently

asked questions about fees and highlights the most common fees, and is designed to encourage participants to make informed investment decisions and to consider fees as a factor in decision making. Last fiscal year, EBSA distributed over 5,400 copies of this brochure, and over 46,000 visitors viewed the brochure on our Web site.

More general information is provided in the publications, *What You Should Know about Your Retirement Plan* and *Taking the Mystery out of Retirement Planning*. In the same period, EBSA distributed over 86,000 copies of these two brochures, and almost 102,000 visitors viewed these materials on our Web site. EBSA's *Study of 401(k) Plan Fees and Expenses*, which describes differences in fee structures faced by plan sponsors when they purchase services from outside providers, is also available.

### **Regulatory Initiatives**

EBSA currently is pursuing three initiatives to improve the transparency of fee and expense information to participants, plan sponsors and fiduciaries, government agencies and the public. We began these initiatives, in part, to address concerns that participants are not receiving information in a format useful to them in making investment decisions, and that plan fiduciaries are having difficulty getting needed fee and compensation arrangement information from service providers to fully satisfy their fiduciary duties. The needs of participants and plan fiduciaries are changing as the financial services industry evolves, offering an increasingly complex array of products and services.

- **Disclosures to Participants**

EBSA currently is developing a proposed regulation addressing required disclosures to participants in participant-directed individual account plans. This regulation will ensure that participants have concise, readily understandable information they can use to make informed decisions about the investment and management of their retirement accounts. Special care must be taken to ensure that the benefits to participants and beneficiaries of

any new requirement outweigh the compliance costs, given that any such costs are likely to be charged against the individual accounts of participants.

On April 25, 2007, the Department published a Request for Information to gather data to develop the proposed regulation. The Request for Information invited suggestions from plan participants, plan sponsors, plan service providers, consumer advocates and others for improving the current disclosures applicable to participant-directed individual account plans and requested analyses of the benefits and costs of implementing such suggestions. The Department specifically invited comment on the recommendation of the Government Accountability Office that plans be required to provide a summary of all fees that are paid out of plan assets or directly by participants, as well as other possible approaches to improving the disclosure of plan fee and expense information.

In response to our Request for Information, the Department received many comments highlighting the importance of brevity and relevance in fee disclosures to participants. Commenters suggested that one or more methods of aggregating fee information would provide participants with meaningful and useful disclosure. The information we received also makes it clear that excessively detailed disclosures are likely to confuse participants or to be ignored. Disclosures intended for participants should illuminate, not confuse, especially when it is those participants that must bear the potentially significant cost of the preparation and distribution.

In connection with this initiative, EBSA is also working with the Securities and Exchange Commission (SEC) to develop a framework for disclosure of information about fees charged by financial service providers, such as mutual funds, that would be more easily understood by participants and beneficiaries. Improved mutual fund disclosure would assist plan participants and beneficiaries because a large proportion of 401(k) plan assets are invested in mutual fund shares. We are working closely with the SEC to ensure that the disclosure requirements under our respective laws are complementary.

We are hopeful that improved fee disclosure will assist plan participants and beneficiaries in making more informed decisions about their investments. Better disclosure could also lead to enhanced competition between financial service providers which could lead to lower fees and enhanced services.

- Disclosures to Plan Fiduciaries

EBSA will soon be issuing a proposed regulation amending its current regulation under ERISA section 408(b)(2) to clarify the information fiduciaries must receive and service providers must disclose for purposes of determining whether a contract or arrangement is "reasonable," as required by ERISA's statutory exemption for service arrangements. Our intent is to ensure that service providers entering into or renewing contracts with plans disclose to plan fiduciaries comprehensive and accurate information concerning the providers' receipt of direct and indirect compensation or fees and the potential for conflicts of interest that may affect the provider's performance of services. The information provided must be sufficient for fiduciaries to make informed decisions about the services that will be provided, the costs of those services, and potential conflicts of interest. The Department believes that such disclosures are critical to ensuring that contracts and arrangements are "reasonable" within the meaning of the statute. This proposed regulation currently is under review within the Administration.

- Disclosures to the Public

EBSA will soon promulgate a final regulation revising the Form 5500 Annual Report filed with the Department to complement the information obtained by plan fiduciaries as part of the service provider selection or renewal process. The Form 5500 is a joint report for the Department of Labor, Internal Revenue Service (IRS) and Pension Benefit Guaranty Corporation (PBGC) that includes information about the plan's operation, funding, assets, and investments. The Department collects information on service provider fees through the Form 5500 Schedule C.

Consistent with recommendations of the ERISA Advisory Council Working Group, the Department published, for public comment, a number of changes to the Form 5500, including changes that would expand the service provider information required to be reported on the Schedule C. The proposed changes more specifically define the information that must be reported concerning the "indirect" compensation service providers received from parties other than the plan or plan sponsor, including revenue sharing arrangements among service providers to plans. The proposed changes to the Schedule C were designed to assist plan fiduciaries in monitoring the reasonableness of compensation service providers receive for services and potential conflicts of interest that might affect the quality of those services. EBSA has completed its review of public comments on the proposed Schedule C and other changes to the Form 5500 and expects to have a final regulation and a notice of form revisions published within the next few weeks.

We intend that the changes to the Schedule C will work in tandem with our 408(b)(2) initiative. The amendment to our 408(b)(2) regulation will provide up front disclosures to plan fiduciaries, and the Schedule C revisions will reinforce the plan fiduciary's obligation to understand and monitor these fee disclosures. The Schedule C will remain a requirement for plans with 100 or more participants, which is consistent with long-standing Congressional direction to simplify reporting requirements for small plans.

### **EBSA's Enforcement Efforts**

EBSA has devoted enforcement resources to this area, seeking to detect, correct and deter violations such as excessive fees and expenses, and failure by fiduciaries to monitor on-going fee structure arrangements. Over the past nine years, we closed 354 401(k) investigations involving these issues, with monetary results of over \$64 million.

In carrying out its enforcement responsibilities, EBSA conducts civil and criminal investigations to determine whether the provisions of ERISA or other federal laws related to employee benefit plans have been violated. EBSA regularly works in coordination

with other federal and state enforcement agencies, including the Department's Office of the Inspector General, the IRS, the Department of Justice (including the Federal Bureau of Investigation), the SEC, the PBGC, the federal banking agencies, state insurance commissioners, and state attorneys general.

EBSA is continuing to focus enforcement efforts on compensation arrangements between pension plan sponsors and service providers hired to assist in the investment of plan assets. EBSA's Consultant/Adviser Project (CAP), created in October 2006, addresses conflicts of interest and the receipt of indirect, undisclosed compensation by pension consultants and other investment advisers. Our investigations seek to determine whether the receipt of such compensation violates ERISA because the adviser or consultant used its status with respect to a benefit plan to generate additional fees for itself or its affiliates. The primary focus of CAP is on the potential civil and criminal violations arising from the receipt of indirect, undisclosed compensation. A related objective is to determine whether plan sponsors and fiduciaries understand the compensation and fee arrangements they enter into in order to prudently select, retain, and monitor pension consultants and investment advisers. CAP will also seek to identify potential criminal violations, such as kickbacks or fraud.

## **Conclusion**

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify before you today. The Department is committed to ensuring that plans and participants pay fair, competitive and transparent prices for services that benefit them – and to combating instances where fees are excessive or hidden. We are moving as quickly as possible consistent with the requirements of the regulatory process to complete our disclosure initiatives, and we believe they will improve the retirement security of America's workers, retirees and their families. I will be pleased to answer any questions you may have.



The CHAIRMAN. Thanks, Mr. Campbell.

Ms. BOVBJERG, what would you say is the best way to provide 401(k) participants with information about the fees they are paying so that they can make wise investments?

Ms. BOVBJERG. Clearly, comprehensively, but simply. That of course is the trick. We have had difficulties in doing this in even things like our Social Security statements.

We have had difficulties with the disclosures that we make to credit card holders, for example. I think that the trick in these efforts is to focus on providing information and improving understanding, and not simply meeting a legal requirement.

We reported last year with regard to credit card disclosures that it was the tiny typeface problem. It was too much information. It was prepared in a way to meet a legal requirement rather than actually explain something to individuals who varied tremendously in their ability to understand these things.

The CHAIRMAN. I have heard employers say that it is impossible to determine all the fees that individual participants pay. While I do understand that some fees are assessed plan-wide and difficult to calculate to the penny, what is your understanding of the ability of plans to reasonably estimate the actual fees that are paid by participants?

Ms. BOVBJERG. I think that it is their fiduciary duty to know what fees the plans are charging for participants, whether it is directly assessed to the participant or whether it is being assessed to the sponsor.

The CHAIRMAN. Mr. Campbell, the Department of Labor has been talking about fee disclosure, as you know, since back in the 1990's. So what date can we expect the Department of Labor to have regulations that would require clear disclosure of fees to all employers and to all plan participants?

Mr. CAMPBELL. Yes, sir. The first of our three initiatives will be final regulation within the next several weeks. That is the Form 5500 disclosures to the public and the government.

The second regulatory initiative, service provider disclosures to plan fiduciaries, will be proposed within the next several months. We will be issuing a proposed regulation governing disclosures to participants by plans this winter. So these are moving along very well.

I would say with respect to the previous initiatives you are referring to in the 1990's, those were in the same area, but they are not these initiatives. These initiatives were begun last year. We are making very good progress by the standards of regulatory time, recognizing that it is a deliberative process and does have to follow the legal requirements of the process.

The CHAIRMAN. Current ERISA law dictates that the plan sponsors should ensure that all 401(k) fees are reasonable. How has the Department of Labor been defining reasonable? How has the Department of Labor been enforcing this requirement? How many cases have been brought specifically on this issue?

Mr. CAMPBELL. The requirement in the statute, as you say, is that these fees must be reasonable, and plan fiduciaries bear the duty of ensuring that. The determination is on a facts and circumstances basis.

The fiduciary is responsible for looking at each service provider, the services they are providing, the cost of those services, doing due diligence and comparing them to other service providers to ensure that they are following—again, to use the same word—a reasonable process in gathering the information necessary to make that determination.

The Labor Department does review, when we do investigations, the fees and expenses that are being paid. Over the last several years, we have brought I believe on the order of 350 or so cases that involve fee and expense issues. This is part of the reason we concluded that, rather than piecemeal enforcement, a regulatory effort was necessary to globally address these issues.

One of the more significant regulations with respect to the reasonableness of fees is ensuring that fiduciaries have the information they need to assess whether they are reasonable. One of those considerations, for example, would be indirect payments coming to service providers from third parties.

Fiduciaries need to be aware of those so they can factor that into whether they are paying a reasonable amount and how the assets of the plan are being used in connection with the Financial Services industry. Providing that disclosure will help ensure that those fees are reasonable.

The CHAIRMAN. Thank you, Mr. Campbell.

We turn now to Senator Smith.

Senator SMITH. Thank you, Mr. Chairman. Your excellent testimony answered most of my questions. Barbara, when you indicated in your answer to Senator Kohl that information needs to be clear, comprehensive and simple, those are sort of at cross-purposes, and that is the problem I suppose the industry has, and you acknowledge.

Have you seen an example that we could highlight for the hearing purposes that really accomplishes all those three objectives?

Ms. BOVBJERG. We provided a little table in my statement that suggests a way that you could disclose this information. It is a composite of things we have gotten from different sources, including some of the work from the Department of Labor.

It is pretty simple. It shows asset allocation, and it shows, on a percentage basis, the fees that are assessed against assets. It suggests that you would show the loan fees or things of that nature in dollars.

There are many different ways to do it. I recognize that you are concerned that a comprehensive disclosure may include too many things. You want to capture the main things.

I don't want to suggest that you could capture everything and provide it to people, and that they would still read it and understand it. But I think you might focus on the main things, and try to keep it simple when you do that.

Senator SMITH. Brad, you indicated in your testimony that this is a high priority. I am glad to hear that. I think it is important, and so I commend the department for making it such a high priority.

Thank you, Mr. Chairman.

The CHAIRMAN. Well, we thank you, Senator Smith, and we thank you, Ms. Bovbjerg, Mr. Campbell. Your testimony has been

informative, valuable, and we appreciate your being here. Thank you so much.

Ms. BOVBJERG. Thank you for having us.

Mr. CAMPBELL. Thank you, sir.

The CHAIRMAN. We are going to turn now to our second panel. There is a scheduled vote, and then another vote to start at 11 a.m., so I hope we can figure it out to see that we get our testimony and questions in.

Our first witness on the second panel will be Jeff Love. Mr. Love is the director of Strategic Issues Research at the AARP. Mr. Love has extensive experience in research methods, providing this expertise for AARP on their top legislative issues. Mr. Love is here today to testify on some of his findings regarding participant awareness of 401(k) fees.

Second witness will be Mercer Bullard. Mr. Bullard is recognized as one of the nation's leading advocates for mutual fund shareholders, and he is currently an assistant professor of Law at the University of Mississippi. In 2000, Mr. Bullard founded Fund Democracy, a nonprofit membership organization that advocates for mutual fund shareholders.

Our third witness will be Michael Kiley. Mr. Kiley is the founder and CEO of Plan Administrators, Inc., and has over 20 years of experience in providing affordable retirement plan servicing to small businesses. His company is a two-time winner of the U.S. Chamber of Commerce Blue Ribbon Small Business Award.

Mr. Kiley is an active member of the American Society of Pension Actuaries, the National Institute of Pension Administrators, Society of Professional Administrators and Record-Keepers, and a Corporate Executive Board Retirement Services Roundtable.

Senator Smith.

Senator SMITH. I will introduce Bob Chambers. OK.

Bob Chambers is a partner at Helms, Mullis & Wicker. Mr. Chambers is testifying on behalf of American Benefits Council, the American Council of Life insurers, and the Investment Company Institute. Mr. Chambers will provide the plan sponsor perspective to the Plan C disclosure issue.

The CHAIRMAN. Thank you so much. Mr. Love, we will take your testimony.

#### **STATEMENT OF JEFF LOVE, DIRECTOR OF RESEARCH, AARP, WASHINGTON, DC**

Mr. LOVE. Thank you, Mr. Chairman. Mr. Chairman Kohl, Senator Smith, thank you very much for having us this morning. AARP appreciates the opportunity to speak with you today about a very important topic and a survey we conducted on that topic. As you noted, I am Jeffrey Love. I am the director of Research at AARP.

We have a survey that we recently fielded on awareness and understanding of fees by those participants who are involved in them. In recent years, 401(k) retirement savings plans and other defined contribution plans have become the main stay of many Americans' retirement security.

More than 60 percent of workers with pension coverage have only a 401(k) or other defined contribution plan, compared to 20

percent a generation ago. All evidence suggests that worker reliance on defined contributions will continue to escalate.

In light of the prevalence of 401(k) plans and the critical role that 401(k) plans can play in an individual's retirement security, AARP commissioned a nationally representative survey of 1,584 401(k) plan participants, ages 25 and older, in order to gauge awareness and knowledge of fees and expenses charged by 401(k) plan providers.

The survey was fielded from June 8 through June 24, 2007, by Knowledge Networks of Menlo Park, CA, to members of a nationally representative panel online. The survey findings are in a document titled, "401(k) Participant Awareness and Understanding of Fees." This is available outside on the table and has been made available to the panel. You can also find it on AARP's Web site, [AARP.org](http://AARP.org).

Now, the findings. What the survey reveals, as Senator Smith noted earlier, that many 401(k) participants lack even basic knowledge of the fees associated with their plans, including whether or not they pay fees at all and, if so, how much they pay. When asked whether they pay fees for their 401(k) plan, nearly two-in-three, 65 percent plan participants, reported they pay no fees, and about one-in-six say that they do pay fees. Only about 17 percent recognize that they pay fees on their 401(k)'s. Another 18 percent admitted they do not know whether or not they pay fees or not. They had no idea.

After being told that 401(k) plan providers often charge fees for administering their plans and that these fees may be paid either by the employer or by the plan—or the employees who participate in the plan, the vast majority, 83 percent of respondents, acknowledged they do not know how much they pay in fees.

About one-in-six, only 17 percent participants, reported they know how much they pay to their 401(k) fees. That is only one-in-six. But over half, 54 percent, are not too or not at all knowledgeable about the impact these fees will have on their total retirement savings.

Similarly, few can identify the different types of fees assessed by plan providers. When given possible definitions of three types of fees, about half can identify an administrative fee, 38 percent can identify a redemption fee, and only 14 percent can correctly choose the definition of an expense ratio.

We know that 87 percent of all 401(k) plans are participant-directed. The participants make decisions about how their money will be invested. We also know from our survey that eight in ten participants consider information about fees to be important in their investment decisions, and that most participants sense that the fees have a potential to reduce their return on investment in their 401(k) plans.

The lack of participant knowledge about fees, coupled with the expressed desire for a better understanding of fees, suggests that information about plan fees should be distributed regularly, in plain language, to current and perspective plan participants. Six in ten, 61 percent, feel that information about fees should be distributed on a regular basis, and almost eight in ten, 77 percent, prefer this information to be written in paper.

AARP recommends that fee information be presented in a chart or graph that depicts the range of possible effects that total annual fees and expenses can have on a participant's account balance in a year and over the long-term. Providing such information about fees will help current and perspective plan participants make better choices and better comparisons and improved choices about their investments.

If workers don't start getting around understanding what 401(k) fee information and the effect it has on their plans, they risk seeing a sizable portion of their retirement saving eaten up by fees, which they are unaware.

Thank you.

[The prepared statement of Mr. Love follows:]



**TESTIMONY BEFORE THE  
SENATE SPECIAL COMMITTEE ON AGING**

**ON**

**HIDDEN 401(k) FEES**

October 24, 2007

WASHINGTON, D.C.

**WITNESS: JEFF LOVE  
RESEARCH DIRECTOR**

For further information  
Contact: Frank Toohey  
Federal Affairs Department  
(202) 434-3760

Mr. Chairman and members of the Committee, I am Jeffrey Love, Research Director at AARP. Thank you for convening this hearing.. AARP appreciates the opportunity to discuss the important findings of our recent survey of 401(k) participants' awareness and understanding of fees.

In recent years, 401(k) retirement savings plans and other defined contribution plans have become the mainstay of many Americans' retirement security. More than 60 percent of workers with pension coverage have only a 401(k) or other defined contribution plan compared to under 20 percent of workers with such plans a generation ago. All evidence suggests that worker reliance on defined contribution will continue to escalate.

In light of the prevalence of 401(k) plans and the critical role that 401(k) plans can play in an individual's retirement security, AARP commissioned a nationally representative survey of 1,584 401(k) plan participants ages 25 and older in order to gauge awareness and knowledge of fees and expenses charged by 401(k) plan providers. The survey was fielded from June 8<sup>th</sup> through June 24<sup>th</sup>, 2007, by Knowledge Networks of Menlo Park, California, to members of its nationally representative online panel. The report of the survey findings, ***401(k) Participants' Awareness and Understanding of Fees*** is available on the AARP website (aarp.org) and copies have been made available at today's hearing.

What this survey reveals is that many 401(k) participants lack even basic knowledge of the fees associated with their plans, including whether they pay fees at all and, if so, how much they pay.

When asked whether they pay any fees for their 401(k) plan, nearly two in three (65%) 401(k) plan participants surveyed reported that they pay no fees and only about one in six (17%) stated that they do pay fees. Another 18 percent admitted that they do not know whether or not they pay any fees.

After being told that 401(k) plan providers often charge fees for administering their plans and that these fees may be paid by either the employer that sponsors the plan or the employees who participate in the plan, the vast majority (83%) of respondents acknowledged that they do not know how much they pay in fees. Only about one in six (17%) 401(k) participants reported that they know how much they pay in fees and expenses for their plan, but over half (54%) are not too or not at all knowledgeable about the impact fees can have on their total retirement savings.

Few can identify the different types of fees assessed by plan providers. When given possible definitions of three types of fees, about half can identify an administrative fee; 38% can identify a redemption fee; and only 14% can correctly choose the definition of an expense ratio.



We know that 87 percent of all 401 (k) plans are participant-directed – participants make decisions about how their money will be invested. We also know from our survey that eight in ten 401 (k) participants consider information about fees to be important in their investment decisions, and that most participants sense that fees have the potential to reduce their return on investment.

Lack of participant knowledge about fees coupled with the expressed desire for a better understanding of fees suggests that information about plan fees should be distributed regularly and in plain language to current and prospective plan participants. Six in ten (61%) feel that information about fees should be distributed on a regular basis, and almost eight in ten (77%) prefer this information in written form on paper. AARP recommends that fee information be presented in a chart or graph that depicts the range of possible effects that the total annual fees and expenses can have on a participant's account balance in a year and over the long term.

Providing such information about fees will help current and prospective plan participants make better comparisons and more informed choices about their investments. If workers don't start getting around understanding 401(k) fee information, they risk seeing a sizable portion of their retirement savings eaten up by fees of which they are unaware.

The CHAIRMAN. Thank you, Mr. Love.  
We turn now to Mr. Bullard.

**STATEMENT OF MERCER BULLARD, ASSISTANT PROFESSOR,  
THE UNIVERSITY OF MISSISSIPPI, SCHOOL OF LAW, UNIVER-  
SITY, MS**

Mr. BULLARD. Good morning, Chairman Kohl, Ranking Member Smith. Thank you for the opportunity to discuss 401(k) fees here with you this morning.

We are here today because 401(k) fees are crucially important to the retirement security of over 40 million investors. At the risk of restating oft-repeated data, I would like to direct your attention to the chart on my right.

The three purple bars on the chart show the balances after an initial \$10,000 investment in a 401(k) plan S&P 500 Index Fund, assuming three different expense ratio scenarios—.4 percent, .8 percent, and 1.2 percent. I would like to thank Craig Israelsen, an economics professor with Brigham Young University, for putting this chart together for this hearing.

The plan with the .4 percent expense ratio has a balance of about \$69,000 after taxes, the .8 percent expense ratio about \$64,000, and the 1.2 percent expense ratio about \$60,000. Obviously, what appears to be a relatively small difference in fees produces a significant difference in value.

The blue bar on the left shows the after-tax balance in a taxable account, not a 401(k) plan, invested in the Vanguard S&P 500 Index Fund from 1987 to 2006. This is a real fund, and its expense ratio during this period ranged from .26 percent to 1.18 percent. The balance is \$3,500 greater than the .4 percent fee in the 401(k) plan and \$13,000, or 21 percent higher, than the 1.2 percent 401(k) plan. Now, not only do fees matter within a 401(k) plan, the 401(k) fees can actually undermine the tax benefits of the 401(k) plan altogether and leave employees better off investing elsewhere.

Now, this chart actually reminds us that fees matter, but does more than that. I would like to use it to make just three points about fee disclosure.

First, note that the bar chart translates expense ratios into hard dollars. Why is it that the GAO and the SEC, congressional witness and Chairman Kohl discuss the impact of fees this morning? Why don't they simply say fees are important because 1.2 percent is greater than .8 percent, or that .8 percent is twice as much as .4 percent? Why do they always use dollars when they describe the impact of fees?

The answer is that we understand dollar amounts better than percentages. We appreciate the fact that a \$10,000 difference in our balance when we begin retirement will have a significant impact on our standard of living. Yes, fees do matter, and they matter enough to highlight for plan beneficiaries. Then, shouldn't they be disclosed in the same way that virtually all commentators use to illustrate the importance of fees?

Perhaps fee-savvy investors understand that a .4 percent difference in fees will have a substantial impact on their balances, but we are here today because the Committee recognizes that many 401(k) beneficiaries are not fee-savvy. We regulate fee disclosure

precisely to communicate with investors who are not fee-sensitive, not with those investors who are fee-savvy.

So my first point is 401(k) fee disclosure should provide investors with a close estimate of the dollar amount of fees that they actually pay. My second point is the fee comparisons are crucial to effective fee disclosure. The reason this chart is effective is not just that it discloses fees in dollar amounts.

It is also effective because it shows you the results that you would have achieved under different scenarios. Information has no meaning without context, and investors who are not sensitive to fees in the first place are unlikely to have the context in which to understand stand-alone expense ratios or even stand-alone dollar amounts.

The third point that this chart illustrates is that it is effective because most of the people in this room have actually looked at it, at least those of you who can see it. I had this chart created precisely to get my audience's attention.

The chart is fairly effective because, in a context where I own 5 minutes of your time, I can make it something that you think about. The same principle applies with respect to fees. Fee disclosure is most effective when the delivery vehicle is one that investors are likely to use.

Mr. Campbell has discussed the excellent educational tools and materials on fees his office has made available to the public. But the investor who seeks out those materials is not the investor who is least sensitive to fees. A short form summary of each investment option has been bandied about is a crucial document for investors, but it is unlikely that beneficiaries who are insensitive to fees will use it.

Investors who are insensitive to fees are likely, however, to review their quarterly statements. Most people like to see how much money they have invested, the value of their accounts, how much they have earned in good times, and even how much they have lost in bad times. The quarterly statement is like the chart over there because it is a delivery vehicle that works.

When I see an unexplained \$10 charge on my bank account statement, I find out what it is for. Imagine the effect if the investor in the 401(k) Index Fund with a 1.2 percent expense ratio sees on his quarterly statement that he paid \$225 in fees last quarter and that, right next to that number, shows that he would have paid on \$37 in fees if he had been invested in an Index Fund in the plan that charge only .2 percent, \$225 versus \$37. I hope that you will agree that that is effective fee disclosure.

Thank you again for the opportunity to appear before the Committee. I hope I can help you with any questions you may have.

[The prepared statement of Mr. Bullard follows:]

## Remarks of Mercer Bullard

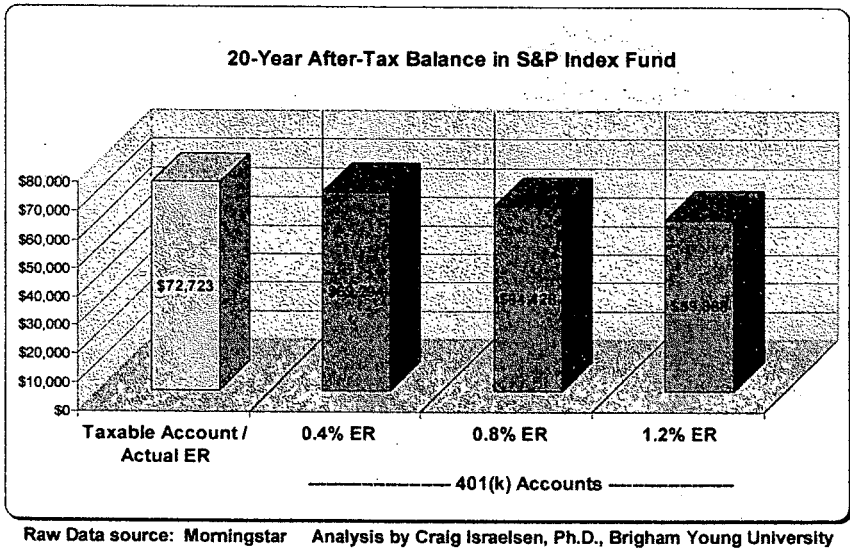
## Hearing on 401(k) Fee Disclosure

Before the Senate Special Committee on Aging

Oct. 24, 2007

Good morning Chairman Kohl, Ranking Member Smith, members of the Committee. Thank you for the opportunity to discuss 401(k) fees with you this morning.

We are here today b/c 401k fees are crucially important to the retirement security of over 40 million Americans. At the risk of restating an oft-repeated set of data, I'd like to direct your attention to the chart on my right [below].



The three purple bars<sup>1</sup> show the after-tax account balance of a \$10,000 initial investment in a 401k plan's S&P 500 index fund option under three different total expense ratios assumptions: .4, .8 and 1.2 percent. I'd like to thank Craig Israelsen, an economics professor with Brigham Young University, for putting this chart together for this hearing.

The plan with a .4% expense ratio has a balance of about \$69,000 after taxes, the .8% expense ratio produces a balance of about \$64,000, and the 1.2% expense ratio

<sup>1</sup> For readers of the black and white version, these are the three bars on the right.

produces about a \$60,000 balance. Obviously, what appears to be a small difference in fees produces a significant difference in value.

The blue bar on the far left<sup>2</sup> shows the after-tax balance of a taxable account invested in the Vanguard S&P 500 index fund from 1987 to 2006. This is a real fund, its expense ratio during the period ranged from 0.26% to 0.18%. The balance is about \$3,500 greater than the .4% fee 401k plan, and about \$13,000, or about 21%, higher than for the 1.2% fee 401k plan. Thus, not only do fees matter within a 401k plan, but high 401k fees can actually undo the tax benefits of the 401k plan altogether and leave employees better off investing elsewhere.

This chart reminds us that fees matter, but it actually does more than that. I'd like to use it to make three points about fee disclosure.

First, note that the bar chart translates expense ratios into hard dollars. Why is it that when the GAO, the SEC, Congressional witnesses -- and Chairman Kohl this morning -- discuss the impact of fees they don't simply say fees are important because 1.2% is greater than .8%, which is twice as much as .4%? Why do they always use dollars when they are describing the impact of fees?

The answer is that we understand dollar amounts better than percentages. We appreciate the fact that a \$10,000 difference in our balance when we begin retirement will have a significant impact on our standard of living. Yes, fees do matter, and if they matter enough to highlight for plan beneficiaries, then shouldn't they be disclosed in the same way that virtually all commentators use to illustrate the importance of fees?

Perhaps fee savvy investors understand that a .4 percentage point difference in fees will have a substantial impact on their account balances in retirement. That is what it means to be fee savvy. And if everyone were fee savvy, we wouldn't be here today. We are here today b/c the committee recognizes that many 401k beneficiaries are not fee sensitive. We regulate fee disclosure precisely to communicate with investors who are not fee sensitive, not with those investors who are fee savvy.

So my first point is that 401k fee disclosure should provide investors with a close estimate of the dollar amount of fees they actually paid.

My second point is that fee **comparisons** are crucial to effective fee disclosure. The reason this chart is effective is not just its disclosure in dollar amounts. It is also effective because it shows you the results you would have achieved in a different investment. Information has no meaning without context, and investors who are not sensitive to fees in the first place are unlikely to have the context in which to understand stand-alone expense ratios or stand-alone dollar amount charges.

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<sup>2</sup> For readers of a black and white version, it is the bar at the far left.

The third point that this chart illustrates is that it is effective because most of the people in this room have actually looked at it. I had this chart created precisely to get my audience's attention. The chart is fairly effective because in a context where I own 5 minutes of your time I can make it something you think about.

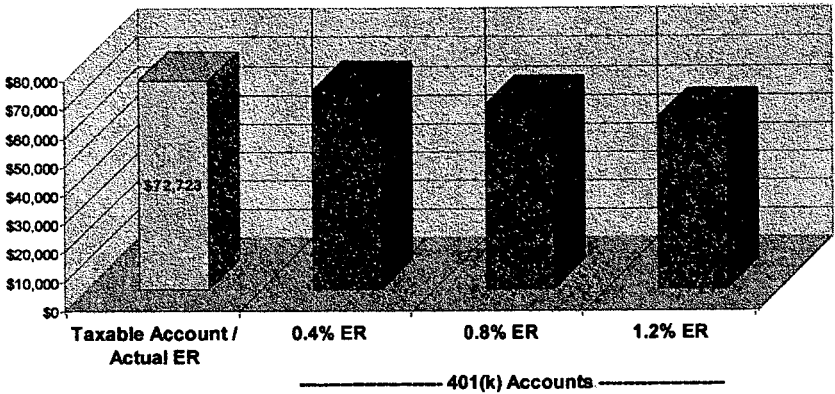
The same principle applies with respect to fees. Fee disclosure is most effective when the delivery vehicle is one that investors are likely to use. Mr. Campbell has discussed the excellent educational materials on fees that his office has made available to the public. But the investor who seeks out those materials is not the investor who is least sensitive to fees. The short form summary of each investment option in a plan is a crucial document for beneficiaries. But it is unlikely that beneficiaries who are insensitive to fees will use it.

Investors who are insensitive to fees are likely, however, to review their quarterly statements. Most people like to see how much money they have invested, the value of their accounts, how much they earned in good times, and even how much they lost in bad times. The quarterly statement is like the chart over there because it is a delivery vehicle that works.

When I see an unexplained \$10 charge on my bank account statement, I find out what it was for. Imagine the effect when the investor in the 401k index fund option with the 1.2% expense ratio sees that he paid \$225 in fees last quarter, and that he would paid only \$37 in fees if he had been invested in an index fund that charged only .2%. \$225 v. \$37. I hope that you will agree that that is effective fee disclosure.

Thank you again for the opportunity to appear before the committee today. I hope that I can help you with any questions you may have.

20-Year After-Tax Balance in S&amp;P Index Fund



Raw Data source: Morningstar Analysis by Craig Israelsen, Ph.D., Brigham Young University

The chart shows the after-tax balance after 20 years in a 401(k) plan under three expense ratio assumptions (0.4%, 0.8% and 1.2%) and in a taxable account that is invested in the Vanguard 500 Index Fund from 1987 to 2006 (when fees ranged from 0.26% to 0.18%). The chart assumes an initial investment of \$10,000, the application of a 20% income tax rate on the ending balance for each of the 401(k) accounts, and a 20% income tax rate and a 15% capital gains rate paid on distributions from the Vanguard Fund on an ongoing basis and a 15% capital gains rate paid on the ending balance after 20 years. Unlike the Vanguard Fund, the 401(k) plan incurs no portfolio transaction costs.

Testimony of Mercer E. Bullard

President and Founder  
Fund Democracy, Inc.

and

Assistant Professor of Law  
University of Mississippi School of Law

before the

Special Committee on Aging

United States Senate

on

401(k) Fee Disclosure

October 24, 2007



## EXECUTIVE SUMMARY

Fee disclosure for 401(k) plans has long been in need of improvement, and I applaud the Committee for taking up this issue. A summary of my recommendations regarding 401k fee disclosure is provided below. The underlying principle behind these recommendations is that fee disclosure should be designed not for the self-directed, fee-sensitive investor, but rather to increase awareness of fees and their impact on investment returns among those retirement plan beneficiaries who are not fee-sensitive. To be effective in reaching these beneficiaries, fee disclosure must provide them with the information they need, in a form they can understand, and at a time when it is useful to them in making and assessing their investment decisions. Current disclosure rules fail each of these standards. With these standards in mind, my principal recommendations are as follows:

- Delivery Vehicles: Require disclosure of fee information: (1) in a plan summary that also includes essential non-fee information that beneficiaries need to evaluate the plan and (2) in the account statement in a way that directs fee-insensitive beneficiaries' attention to the importance of fees.
- Plan Summary: Require disclosure of a fee table that shows: expense ratios for each investment option; total plan expenses for each investment option; the annual dollar amount of expenses paid by a hypothetical \$1,000 account; comparative expense ratios and hypothetical dollar expenses assuming those expense ratios; and separate disclosure of additional (non-expense-ratio) expenses as applicable (see Exhibit A).
- Account Statement: Require disclosure of the dollar amount of fees deducted from the account during the period and the dollar amount of fees that would have been paid in an average, comparable plan.
- Format: Require the Department of Labor to design the fee table and other disclosures in consultation with disclosure experts to ensure that they effectively convey the key information in a way that is both readable and readily understandable by typical beneficiaries.
- Differential Compensation: Where persons who advise retirement plan beneficiaries are permitted to receive differential compensation (which is generally inadvisable), require separate disclosure of differential compensation paid to an adviser prior to the retention of the adviser, at the time of each recommendation of an investment option in connection with which differential compensation is received, and annually as long as the relationship with the adviser continues.

Chairman Kohl, Ranking Member Smith, members of the Committee, thank you for the opportunity to appear before you to discuss 401(k) fee disclosure. It is an honor and a privilege to appear before the Committee today.

I am the Founder and President of Fund Democracy, a nonprofit advocacy group for mutual fund shareholders, and an Assistant Professor of Law at the University of Mississippi School of Law, where I teach securities regulation, law and economics, corporate finance, corporate law and banking law. I was previously an Assistant Chief Counsel in the SEC's Division of Investment Management and an attorney in the investment management practice of Wilmer, Cutler & Pickering (now WilmerHale). I founded Fund Democracy in January 2000 to provide a voice and information source for mutual fund shareholders on operational and regulatory issues that affect their fund investments. Fund Democracy has attempted to achieve this objective in a number of ways, including filing petitions for hearings, submitting comment letters on rulemaking proposals, testifying on legislation, publishing articles, lobbying the financial press, and creating and maintaining an informational Internet site.

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## INTRODUCTION

Fee disclosure for 401(k) plans has long been in need of improvement, and I applaud the Committee for taking up this issue. I believe that fee disclosure reform for 401(k) plans has the potential to bring about substantial reductions in overall plan expenses for beneficiaries and strengthen the foundation of Americans' financial security in retirement.<sup>1</sup> A primary goal of 401(k) regulation should be to ensure that beneficiaries keep as much of the performance of the markets as possible. Excessive investment expenses present one of the most significant impediments to the achievement of this goal. Fees paid by 401(k) beneficiaries directly reduce their investment returns and, as a result, their financial security in retirement. Of course, excessive regulatory compliance costs can also reduce investment returns. For that reason, fee disclosure reforms should be designed so that they generate a net benefit to 401(k) participants. Transparent, standardized fee disclosure can create substantial net benefits for 401(k) beneficiaries by raising fee awareness among beneficiaries and increasing competition among industry participants.

A summary of my recommendations regarding 401k fee disclosure is provided below. The underlying principle behind these recommendations is that fee disclosure should be designed not for the self-directed, fee-sensitive investor, but rather to increase

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<sup>1</sup> Although the focus of this hearing is 401(k) plans, my testimony generally applies to all types of participant-directed plans. In addition, my testimony often uses mutual funds as examples of 401(k) investment options because they are the most common type of 401(k) plan investment option, comprising more than 50 percent of 401(k) assets.

awareness of fees and their impact on investment returns among those retirement plan beneficiaries who are not fee-sensitive. To be effective in reaching these beneficiaries, fee disclosure must provide them with the information they need, in a form they can understand, and at a time when it is useful to them in making and assessing their investment decisions. Current disclosure rules fail each of these standards. With these standards in mind, my principal recommendations are as follows:<sup>2</sup>

- **Delivery Vehicles:** Require disclosure of fee information:- (1) in a plan summary that also includes essential non-fee information that beneficiaries need to evaluate the plan and (2) in the account statement in a way that directs fee-insensitive beneficiaries' attention to the importance of fees.
- **Plan Summary:** Require disclosure of a fee table that shows: expense ratios for each investment option; total plan expenses for each investment option; the annual dollar amount of expenses paid by a hypothetical \$1,000 account; comparative expense ratios and hypothetical dollar expenses assuming those expense ratios; and separate disclosure of additional (non-expense-ratio) expenses as applicable (*see* Exhibit A).
- **Account Statement:** Require disclosure of the dollar amount of fees deducted from the account during the period and the dollar amount of fees that would have been paid in an average, comparable plan.
- **Format:** Require the Department of Labor to design the fee table and other disclosures in consultation with disclosure experts to ensure that they effectively convey the key information in a way that is both readable and readily understandable by typical beneficiaries.
- **Differential Compensation:** Where persons who advise retirement plan beneficiaries are permitted to receive differential compensation (which is generally inadvisable), require separate disclosure of differential compensation paid to an adviser prior to the retention of the adviser, at the time of each recommendation of an investment option in connection with which differential compensation is received, and annually as long as the relationship with the adviser continues.

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<sup>2</sup> My testimony is substantially based on recommendations I developed with Barbara Roper, Director of Investor Protection, Consumer of Federation of America, and provided to the Department of Labor in a letter from Fund Democracy and the Consumer Federation of America dated July 24, 2007.

## BACKGROUND

The importance of 401(k) plan fees needs no detailed elaboration here. As noted by the GAO, 401(k) plan fees “can significantly decrease retirement savings over time.”<sup>3</sup> For example, the GAO estimates that paying an additional 1 percentage point in fees will reducing an account’s ending balance after 20 years by 17 percent.<sup>4</sup> Mutual fund fees have a substantial impact on total 401(k) plan fees because the bulk of 401(k) plan assets are invested in mutual funds. As noted by the SEC, “[t]he focus on fund fees is important because they can have a dramatic impact on an investor’s return.”<sup>5</sup> The GAO’s and SEC’s observations regarding fees apply equally to other 401(k) investment vehicles.

The following bar chart illustrates the potential impact of fees on Americans’ wealth in retirement. The chart shows the after-tax balance after 20 years in a 401(k) plan under three expense ratio assumptions (0.4%, 0.8% and 1.2%) and in a taxable account that is invested in the Vanguard 500 Index Fund from 1987 to 2006 (when fees ranged from 0.26% to 0.18%).<sup>6</sup> The chart shows that what appear to be small differences in fees produce large differences in ending balances. The ending balance of the 401(k) account with the 1.2% expense ratio is \$4,540 lower than the account with the 0.8% expense ratio and \$9,405 lower than the account with the 4% expense ratio. The ending balance of the taxable account invested in the Vanguard Fund is \$3,429 greater than the balance in the 0.4% expense ratio 401(k), and \$12,835, or 21%, greater than the 1.2% expense ratio 401(k). Thus, not only is the impact of fees on retirees’ wealth substantial,

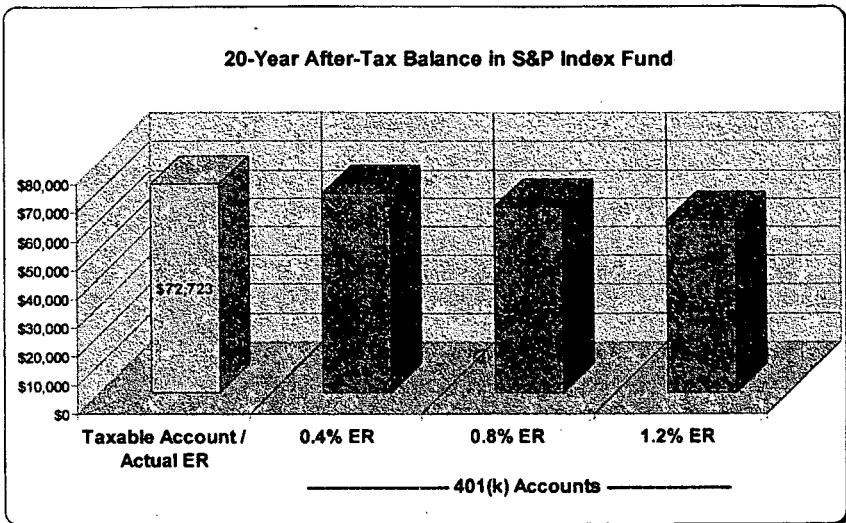
<sup>3</sup> *Private Pensions: Increased Reliance on 401(k) Plans Calls for Better Information on Fees*, Government Accountability Office at 10 (Mar. 6, 2007).

<sup>4</sup> *Id.* See also *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees*, Government Accountability Office (Nov. 2006).

<sup>5</sup> *Report of Mutual Fund Fees and Expenses*, SEC Division of Investment Management at Part 1A (Dec. 2000).

<sup>6</sup> My thanks to Craig Israelsen, PhD, Brigham Young University for preparing this chart. The chart assumes an initial investment of \$10,000, the application of a 20% income tax rate on the ending balance for each of the 401(k) accounts, and a 20% income tax rate and a 15% capital gains rate paid on distributions from the Vanguard Fund on an ongoing basis and a 15% capital gains rate paid on the ending balance after 20 years. Unlike the Vanguard Fund, the 401(k) plan incurs no portfolio transaction costs.

in some cases the impact of fees is so large that the employee is better off foregoing the tax benefits of the 401(k) altogether.<sup>7</sup>



Raw Data source: Morningstar Analysis by Craig Israelsen, Ph.D., Brigham Young University

The amount of fees charged by a 401(k) investment option within any particular investment category is arguably the strongest predictor of its investment performance.<sup>8</sup> For example, researchers have found that mutual funds generally are no more likely, from one quarter to the next, to repeat top-quartile performance as they are to fall into the second, third or fourth tier. To the extent that a small minority of fund managers outperform the markets over the long-term, there is no evidence that investment professionals, much less amateurs, can consistently identify these managers *a priori*. Unlike past investment performance, fees are highly predictable and represent a certain reduction in fund's performance. Thus, within any given asset class, fees arguably

<sup>7</sup> This assumes no matching contributions to the 401(k) plan by the employer, although in some cases a high-cost 401(k) plan actually will eliminate the benefits of a small employer match (e.g., a 1% match). In any case, employees should not have to suffer high 401(k) fees as a condition of receiving employer compensation in the form of a 401(k) match.

<sup>8</sup> Mark Carhart, *On Persistence in Mutual Fund Performance*, 52 J. Fin. 57 (1997) (persistence in mutual fund returns is almost completely explained by expenses and portfolio transaction costs).

constitute the most important factor in the evaluation of different 401(k) investment options.

### FEE-INSENSITIVE INVESTORS

The purpose of fee disclosure is not to provide the minimum information necessary to enable diligent, fee-sensitive investors to evaluate the cost of investing in their 401(k) plan, but rather to draw the attention of all investors, especially fee-insensitive investors, to the importance of fees. The purpose of 401(k) fee disclosure reform therefore should be to provide beneficiaries who are not sufficiently sensitive to the effect of fees on the performance of their 401(k) accounts the information they need to raise their awareness of fees.<sup>9</sup> To emphasize, it is *not* sufficient merely to ensure that fee information is available because making fee information available will not by itself change the behavior of fee-insensitive beneficiaries.

Recent research conducted by the Consumer Federation of America and assisted by Fund Democracy indicates that a large percentage of those who invest through workplace retirement plans are not sensitive to fees.<sup>10</sup> In a recent survey on mutual fund purchase practices, only 51 percent of those respondents who purchased most of their funds through a workplace retirement plan said they considered fees even somewhat important.<sup>11</sup> Furthermore, workplace purchasers were the least fee-sensitive of the three purchase groups identified by the survey.<sup>12</sup> This likely reflects, in part, the fact that workplace purchasers typically make their fund selections from a fairly narrow menu of

<sup>9</sup> Jonathan Clements, Wall St. J. at D1 (July 18, 2007) (citing Morningstar finding that 13% of stock fund assets are invested in fund charging more than 1.5% annually and 24% of bond fund assets are invested in funds charging more than 1% annually).

<sup>10</sup> *Mutual Fund Purchase Practices*, an analysis of survey results by Barbara Roper and Stephen Brobeck, Consumer Federation of America, June 2006.

<sup>11</sup> *Id.* Thirty percent said fees were a very important factor in their fund selection, while 21 percent indicated fees were somewhat important. In contrast, 70 percent indicated fund company reputation was at least somewhat important, while 68 percent rated past performance as at least somewhat important.

<sup>12</sup> *Id.* The other groups were direct purchasers and those who purchased most of their funds through a financial professional outside a retirement plan.

options. However, the relative lack of investing experience and financial sophistication among workplace purchasers almost certainly also plays a role.<sup>13</sup> A recent survey of 401(k) participants' awareness and understanding of fees conducted by the AARP reinforces the findings of the CFA survey.<sup>14</sup> The AARP found that two-thirds of respondents thought that *they did not pay any 401(k) fees* and another 18 percent did not know whether they paid fees. Eighty-three percent did not know how much they pay in fees in their 401(k) plans.

This general lack of investing sophistication is compounded by the fact that the financial media, financial advertisements and the structure of disclosure requirements consistently overemphasize the importance of past investment performance and underemphasize the significance of fees. The financial media's focus on "The Best Funds for 2007" as determined by their short-term investment performance sends exactly the wrong message regarding the factors that investors should consider when evaluating investment options. Financial advertisements focus almost solely on past investment performance, which has little predictive power, to the exclusion of fees, the impact of which is significant, relatively certain and quantifiable.

Furthermore, fee disclosure presents fees almost exclusively as a percentage of assets, which structurally minimizes the true significance of fees in the overall picture of an investor's portfolio. The effects can be seen in the fact that 68 percent of workplace purchasers in the CFA survey indicated that a fund's past performance was at least somewhat important to their selection, with 38 percent indicating it was very important – a far higher percentage than considered fees to be even somewhat important. Similarly, the AARP survey found that 92 percent of respondents rated past performance as very or

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<sup>13</sup> *Id.* Just 12 percent rate themselves as very knowledgeable about mutual funds, while nearly a third (32 percent) rate themselves as knowing only a little. They also tend to be somewhat younger and less educated than other mutual fund purchasers, and to have held mutual fund investments for a shorter period of time, particularly when compared with those who purchased most of their funds directly from a fund company or through a discount broker or fund supermarket.

<sup>14</sup> See *401(k) Participants' Awareness and Understanding of Fees*, AARP (July 2007) available at [http://assets.aarp.org/rgcenter/econ/401k\\_fees.pdf](http://assets.aarp.org/rgcenter/econ/401k_fees.pdf).



somewhat important, compared with only 79 percent who rated fees as very or somewhat important.

For this reason, it is essential that fee disclosure be designed to counter the misleading message that investors generally receive regarding the relative importance of fees. To benefit fee-insensitive investors, fee disclosure must be based on a "push" principle that measures the efficacy of disclosure by its success in promoting competition and efficiency. To accomplish this, fee disclosure for 401(k) plans should be crafted not only to make fee information available, but also to affirmatively direct beneficiaries' attention to fees and to do so in a way that helps them understand those fees and the effect they have on investment returns. In short, fee disclosure should be designed to overcome many investors' predilection for overemphasizing past investment performance and discounting fees when making investment decisions. Investors' fee-insensitivity represents a market failure for which fee disclosure (rather than price regulation) offers the most cost-effective solution.

#### DELIVERY VEHICLES

The delivery vehicles used for fee disclosure play a crucial role in determining whether the disclosure is effective in directing fee-insensitive investors to consider fees when making investment decisions. Yet one of the most significant shortcomings of fee disclosure has been the reliance on investor-unfriendly delivery vehicles. Fees for 401(k) plan administration (*i.e.*, plan-level fees, as apart from fees charged by investment options) are required to be disclosed only in Form 5500, where the fees are disclosed as a dollar amount, in contrast with the presentation of fees as a percentage of assets for most investment options.<sup>15</sup> The Form 5500 is not required to be provided to beneficiaries, but

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<sup>15</sup> See *Private Pensions: Increased Reliance*, *supra* note 3 ("the Form 5500 does not include the largest type of fee, even though plan sponsors receive this information from the mutual fund companies in the form of a prospectus. In 2004, the ERISA Advisory Council concluded that Form 5500s are of little use to policy makers, government enforcement personnel, and participants in terms of understanding the cost of a plan and recommended that Labor modify the form and its accompanying schedules so that all fees incurred directly or indirectly can be reported or estimated. Without information on all fees, Labor's oversight is limited because it is unable to identify fees that may be questionable.").

is delivered only upon request, and is of no value when plan fees are paid through the investment options and the Form reports zero plan-level expenses.<sup>16</sup>

In the mutual fund context, fund expenses are described in the prospectus and the dollar amount of expenses for a hypothetical fund account are provided in the annual report for the period covered. Employers generally provide plan participants with the prospectus or a document that contains the fee information in the prospectus,<sup>17</sup> but they do not provide the annual report or the hypothetical fee information, and neither fund documents or any documents provided by employers provide fee information about comparable investment options. Thus, basic fee information for each investment option is not provided in the same place as plan-level fees, no hypothetical or comparative fee information is provided at all, and no fee information is provided that is specific to a beneficiary's account.<sup>18</sup> Investor-specific information is contained only in the quarterly statement. The latter document is generally the document that investors read, whereas fund prospectuses and plan summaries are more likely to be summarily discarded with little or no review.

Reliance on delivery vehicles currently used to convey 401(k) fee information assumes that investors are proactive and fee sensitive. The prospectus and Form 5500 require 401(k) beneficiaries to request information, calculate their total fees, and seek out

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<sup>16</sup> See H.R. 3185: *The 401(k) Fair Disclosure for Retirement Security Act of 2007*, hearing before the Committee on Education and Labor, U.S. House of Representatives (Oct. 4, 2007) (statement of Tommy Thomasson) ("There are literally tens of thousands of 401(k) plans that report zero costs for recordkeeping and administration on their annual report (Form 5500) filed with the Department of Labor. In actuality, participant accounts are being charged for these 'free' plan services in the form of investment fees assessed against their accounts.").

<sup>17</sup> As discussed further below, although fund expense ratios are standardized, they sometimes are not comparable because expenses that appear in the fund expense ratio for some funds may be excluded from the fund expense ratio for others (e.g., transfer agency expenses may appear either in the fund expense ratio or in plan-level expenses). Expense ratios for non-mutual-fund investment options generally are not even standardized.

<sup>18</sup> See *Private Pensions: Increased Reliance*, *supra* note 3 ("Inadequate disclosure and reporting requirements may leave participants without a simple way to compare fees among plan investment options"); *Changes Needed*, *supra* note 4 (401(k) fee disclosure "is limited and does not provide for an easy comparison among investment options").

comparative data on their own to put their total fees in context. One witness before the ERISA Advisory Council suggested that, by combining Form 5500 and prospectus fee disclosure, a 401(k) beneficiary "should be able to readily calculate the aggregate fees that reduce the value of his or her account."<sup>19</sup> The witness concluded that 401(k) fees are "currently disclosed to participants in sufficient detail to allow participants to evaluate the costs they pay against the services they receive."<sup>20</sup>

I disagree. Few investors, and certainly not fee-insensitive investors, will make the effort to "calculate" fees in the manner described above. As noted above, they simply do not place sufficient emphasis on fees in the first place. In addition, according to the CFA survey, most workplace mutual fund purchasers are unlikely to make use of the written information sources available to them. Just over four in ten (43 percent), for example, rated the prospectus as even somewhat influential on their investment purchases, with only 19 percent rating it as very influential. The AARP found that only 34% of respondents who were involved in investment decisions cited the prospectus among the materials they turn to for guidance when making decisions.

To change the behavior of fee-sensitive beneficiaries, fees must be presented in a document beneficiaries are likely to read, they must be presented in a standardized format, and they must be presented in a manner that makes it easy for beneficiaries to understand how their 401(k) fees compare to fees charged by comparable plans and investment options.<sup>21</sup> Fee disclosure accordingly should focus on two primary delivery vehicles. First, beneficiaries should receive a summary plan document that contains essential information about the plan, including fee information. Second, information

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<sup>19</sup> *Report of the Working Group on Fee and Related Disclosures to Participants*, Advisory Council on Employee Welfare and Pension Benefit Plans at n.4 (2004) (*Advisory Report*) (quoting testimony of John Kimpel, Sr. Vice President and Deputy General Counsel, Fidelity Investments). Actually, the fee dollar amounts in the Form 5500 would have to be converted to a percentage of assets and then added to the investment option's asset-based fees.

<sup>20</sup> *Id.*

<sup>21</sup> See *Private Pensions: Increased Reliance*, *supra* note 3 ("The information on fees that plan sponsors are required to disclose to participants does not allow participants to easily compare the fees for the investment options in their 401(k) plan.").

about fees should be included in account statements. Although the primary purpose of an account statement is to apprise beneficiaries of recent activity in and changes in the value of their accounts, it would be consistent with this purpose to provide limited fee information as well. Beneficiaries are very likely to review their statements, and for the most fee-insensitive among them, fee disclosure in account statements may provide the best and possibly the only realistic opportunity to impress upon them the importance of fees. That being said, adding too much fee information to the account statement runs a significant risk of reducing its effect. Fee information in account statements should be designed to draw the beneficiary's attention to the fees they pay, while minimizing the risk of information overload.

Account statements, however, provide information only after the investment selection has been made. To provide beneficiaries with pre-investment fee disclosures, I also recommend that Congress require that such disclosures be provided in a short document that summarizes the plans' essential features. Such plan summaries should be required to be presented to all employees who are eligible to participate in the plan. Like the account statement disclosure described above, this disclosure should also provide information that enables beneficiaries to easily determine how those fees compare to fees for comparable plans and investment options.

Finally, I strongly recommend that the Committee encourage the use of the Internet and electronic communications as one appropriate delivery vehicle for fee information. The Internet and electronic communications offer the opportunity both to enhance fee disclosure for beneficiaries and to reduce plan expenses. For increasing numbers of investors, the Internet and email constitute their primary information source and communication tool. According to the CFA survey, for example, nearly all workplace investors (91 percent) have access to the Internet, and the vast majority (87 percent) expressed a willingness to use the Internet for at least some mutual fund purchase-related activities. The AARP found that 34 percent of surveyed investors who make financial decisions use the Internets as an information source, with the employer Intranet being the most popular site.

At a minimum, all fee disclosure should be required to be made on or be easily accessible from employer web pages. Where delivery is required, email, including especially employer Intranets, should be mandated as a delivery option investors can choose to use. In appropriate circumstances, such as when an employee has affirmatively decided to use either medium to obtain and receive information, Internet posting and delivery by email should be deemed sufficient to satisfy legal delivery requirements.

### FORM OF FEE DISCLOSURE

Disclosure of 401(k) fees should be provided in two forms. As noted above, 401(k) fees should be disclosed on beneficiaries' account statements, in order to proactively direct beneficiaries' attention to the amount of fees that they pay, and in a plan summary document, to ensure that beneficiaries are made aware of fees when they make their initial investment selections.

Account Statement Fee Disclosure. The 401(k) plan document that investors are most likely to review is their account statement, and Congress therefore should require that account statements include 401(k) fee disclosure. In 2003, the GAO recommended, for example, that the SEC require mutual funds to disclose in shareholders' account statements the dollar amount of fees paid during the period covered.<sup>22</sup> Partly in response to industry claims that dollar disclosure of fees would be ruinously expensive,<sup>23</sup> the SEC decided instead to require the disclosure of the dollar amount of fees charged on a hypothetical account in the annual report.<sup>24</sup> Industry cost claims have proven to be a red herring, as firms such as MFS Investment Management have found it cost-effective to

<sup>22</sup> See *Mutual Funds: Information On Trends In Fees And Their Related Disclosure*, Government Accounting Office (March 12, 2003).

<sup>23</sup> *H.R. 2420: The Mutual Funds Integrity and Fee Transparency Act of 2003*, hearing before the Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (June 18, 2003) (statement of Melody Hobson).

<sup>24</sup> See *Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies*, Investment Company Act Rel. No. 26372 (Feb. 27, 2004).

provide investors with precisely the dollar disclosure of fees on quarterly statements that the industry had argued would be "breathtakingly high."<sup>25</sup> Individualized fee disclosure is obviously affordable, and just as obvious is the need to move it from the annual report, which investors virtually never cite as an information source they use, to the account statement, which they review on a regular basis.

I strongly recommend that Congress require 401(k) plans to disclose the following information in account statements: the dollar amount of total fees paid by the investor for the period covered<sup>26</sup> and the dollar amount that would have been paid in the average comparable plan and investment options. The disclosure of the dollar amount of fees is of particular value because beneficiaries are more accustomed to thinking about expenses in dollars rather than percentages. Fee-insensitive beneficiaries are more likely to take notice of disclosure that looks more like a common bill for services than a mathematical calculation. Dollar disclosure will translate somewhat esoteric expense ratios into more understandable dollar amounts and cause any beneficiary who is paying higher than average fees to rethink whether the services provided are worth the price.

One drawback of both dollar amount and percentage fee disclosures is that they may mean little to beneficiaries without a comparative context in which to place them. The AARP survey referenced above showed the effect that comparative fee information can have. When presented with two funds that differed only as to the size of their expense ratios, seventy-nine preferred the fund with the lower expense ratio. If investors are presented with clear comparative data, they will know what to do with it. I believe that this disclosure would do more to promote competition among 401(k) services providers and drive down fees than any other form of fee disclosure.

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<sup>25</sup> See H.R. 2420, *supra* note 23 (statement of Melody Hobson) (claiming that account statement fee disclosure would impose "breathtakingly high costs"); *Bundled Provider of the Year*, Defined Contribution News, 2005 WLNR 7781126 (Apr. 18, 2005) (regarding MFS disclosure).

<sup>26</sup> It is my understanding that the fee disclosure provided by MFS uses the simplifying assumption that there have been no purchases or redemptions during the period other than reinvestment of fund distributions, which still would provide an effective reminder of the amount of fees paid.

Plan Summary Fee Disclosure. Fee disclosure for 401(k) plans should be provided in the plan summary document and standardized to facilitate comparisons across different investment options within 401(k) plans and to expenses in other comparable plans. To some extent, standardization of investment option fees already exists. For example, mutual funds are required to use a standardized format for their expenses ratios and other expenses. Other types of 401(k) investment options use non-standardized fee disclosure, however, which prevents investors from comparing the true cost of different investment options. The goal of standardization is further frustrated by the fact that payments for services sometimes occur at the investment option level and sometimes at the plan level. For example, 401(k) plans that invest in a retail class of mutual fund shares often pay lower plan expenses, because the mutual fund rebates part of its fees to the plan administrator to cover those expenses. If the mutual fund's fees are compared to investment options that do not use such a rebate structure, the mutual fund's fees will appear higher. An accurate fee comparison generally can be made only when the plan's total fees are disclosed in a standardized format.

There are a number of potential solutions to the standardization challenge. One solution would be for Congress to impose fee disclosure requirements on non-mutual-fund investment options that are similar to those for mutual funds. Such standardization is clearly in the best interests of beneficiaries. Congressional action has the advantage of avoiding interagency conflicts that will arise if rulemaking is left to the Department of Labor. A number of different agencies have primary responsibility for fee disclosure rules for various 401(k) investment options, and it is unlikely that the Department would be able to bring these agencies' rules into alignment. I therefore recommend that Congress enact legislation that preempts potential interagency conflicts and paves the way for standardized fee disclosure at least across all 401(k) investment options.

Another potential solution would be to require the disclosure of 401(k) fees on a functional basis. For example, fees for transfer agency functions could be identified separately, which would permit comparisons of these fees across different plans regardless of whether the fees were collected by the plan administrator, or by a mutual

fund and then rebated to the plan administrator. The downside of functional fee disclosure is that it may be administratively burdensome and excessively costly without providing a material benefit to plans fiduciaries and beneficiaries. Fees generally are not disclosed on a functional basis under existing legal rules for collective investment vehicles or for 401(k) plans, and the cost of designing and implementing new systems to provide functional disclosure might not be justified. In any case, it is not clear that functional fee disclosure as a general matter is a cost-effective disclosure approach, and it can be misleading.<sup>27</sup>

These concerns are reflected in the problem of treating bundled and unbundled fee arrangements consistently.<sup>28</sup> Requiring disclosure of fees received by each service provider on a functional basis may distort competition if bundled providers are not subject to the same requirement. If bundled providers (*i.e.*, providers who provide all or a wide range of fees under one fee) are required to break out their fees functionally, fees might rise, especially if individual service provider's willingness to charge such fees is contingent on their fee not being separately disclosed. Similarly, unbundled providers may negotiate special deals that are conditioned on their remaining confidential. This principle is illustrated by Internet travel agent Travelocity's policy that it will not break out separately the part of a package deal that is separately-attributable to the flight, hotel and rental car.<sup>29</sup>

I believe that the best immediate solution to the problem of standardizing 401(k) fees is to present each fee component in the context the plan's total fees. Toward this

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<sup>27</sup> For example, one of the problems with mutual fund 12b-1 fees, which purport to reflect the use of mutual fund assets for distribution services, is that investors in funds that do not charge 12b-1 may actually pay as much for distribution services as investors in 12b-1 fee funds. It can be extremely difficult to define precisely the different types of services for purposes of functional disclosure of fees.

<sup>28</sup> See generally H.R. 3185: *The 401(k) Fair Disclosure for Retirement Security Act of 2007*, hearing before the Committee on Education and Labor, U.S. House of Representatives (Oct. 4, 2007) (statement of Tommy Thomasson) (discussing problem of functional fee disclosure).

<sup>29</sup> Travelocity confirmations contain the following disclosure: "The TotalTrip combines special rates that we receive from our air, hotel, and car suppliers for package inclusions. Our agreements with such suppliers prohibit us from breaking down the prices for the individual components. Our packages offer customers the convenience and savings of booking their entire trip in one transaction."



end, the standardization of 401(k) fees should be accomplished through the use of a fee table (including a fee example) and a list of additional expenses as described below.<sup>30</sup>

**Fee Table.** As illustrated in Exhibit A, the fee table would include three categories of data for each investment option. These are: the investment option expense ratio,<sup>31</sup> total plan fees (including both the investment option fees and plan-level fees) as a percentage of assets, and the dollar amount of annual fees on a hypothetical \$1,000 account. For each category, a comparative expense figure would also be included. This approach has the advantage of permitting easy comparison of different investment options when the investment options' expense ratios are comparable, such as for mutual funds. The total expense ratio figure not only would provide a total cost figure, it also would help address the problem of non-comparable investment fee information. Where easily comparable fee information of the type provided by mutual funds is not available,<sup>32</sup> it would indirectly indicate the relative cost of different investment options, because the plan-level expenses for each option generally could be assumed to be relatively constant. Assuming that plan-level expenses are comparable across different investment options, to the extent that the total expense ratio for different investment options differed, the difference generally would be attributable to the cost of the investment options.

<sup>30</sup> The overall structure of this approach is similar to the mutual fund fee table, which includes an expense ratio, a list of other expenses, and a dollar-amount fee illustration.

<sup>31</sup> I note that a significant failing of the mutual fund expense ratio is its omission of portfolio transaction costs, which can equal many multiples of a fund's other expenses. See Jason Karczeski, Miles Livingston and Edward O'Neal, *Portfolio Transaction Costs at U.S. Equity Mutual Funds* (2004), available at [http://www.zeroalphagroup.com/news/Execution\\_CostsPaper\\_Nov\\_15\\_2004.pdf](http://www.zeroalphagroup.com/news/Execution_CostsPaper_Nov_15_2004.pdf). Although the SEC has requested comments on ways to address this omission, it has yet to take final action. See *Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs*, Investment Company Act Rel. No. 26313 (Dec. 18, 2003). I strongly encourage the Department to work with the SEC and with other regulators to ensure that the mutual fund expense ratio and the expense ratio of other investment options include all of the relative costs of investing.

<sup>32</sup> As noted *supra* note 17, although fund expense ratios are standardized, they sometimes are not comparable because expenses that appear in the fund expense ratio for some funds may be excluded from the fund expense ratio for others (e.g., transfer agency expenses may appear either in the fund expense ratio or in plan-level expenses). This distinction is partly responsible for the recent flurry of excessive fee cases brought against employers in connection with their 401(k) plans.

**Additional (Non-Expense-Ratio) Expenses.** By making expenses charged through asset-based fees more visible, this approach may create an incentive to shift costs to other forms. To minimize any such cost-shifting designed to avoid disclosure, additional disclosures should be provided along with the fee table listing expenses that are not included in the expense ratio table but that may be incurred directly or indirectly by beneficiaries. These expenses would include, for example, purchase and redemption fees, minimum account charges, and non-asset-based sales charges. These expenses should be presented as a percentage of assets or a dollar amount, depending on the basis on which they are deducted, with explanations as appropriate.

One disadvantage of the foregoing approach is that it may not fully remove the incentive to shift expenses, in this case from the expense ratio to the additional expenses category. For example, a 401(k) provider could reduce the plan's expense ratio by replacing an asset-based transfer agency fee with a flat fee for each account. This strategy would have the effect of artificially reducing the expense ratio, on the assumption that investors would pay less attention to the concomitant increase in the expenses listed as additional expenses. The problem of expenses being shifted out of the expense ratio would also be mitigated by the disclosure in account statements of the total dollar amount of fees charged during the period, which would include fees not included in the expense ratio.

## CONFLICTS OF INTEREST AND DIFFERENTIAL COMPENSATION

One of the most difficult challenges presented by fee disclosure is the need to apprise plan fiduciaries and beneficiaries of the conflicts of interests that differential compensation can create. Differential compensation refers to arrangements whereby salespersons are paid more for selling products offered by one financial services provider than for selling those offered by another provider. In its recent survey of pension consultants who advise fiduciaries regarding investment options and other matters, the SEC found: (1) that most pension consultants receive compensation from *both plans and money managers*, with compensation from money managers in some cases comprising a significant part of their revenue, (2) that most pension consultants have affiliates (e.g., broker-dealers) through which they receive compensation from plans that advise, (3) evidence that consultants were more likely to recommend money managers from whom they received compensation, and (4) that consultants frequently provided inadequate disclosure of the conflict of interest created by these arrangements.<sup>33</sup> The SEC has brought enforcement actions against certain consultants for failing to disclose fully their conflicts of interest in connection with their pension consulting business.<sup>34</sup>

As previously recommended by the GAO, Congress should amend ERISA "to explicitly require that 401(k) service providers disclose to plan sponsors the compensation that providers receive from other service providers."<sup>35</sup> The disclosure should expressly identify the conflict of interest created by such arrangements and be designed so as to specifically and separately draw the fiduciary's attention to the conflict. The disclosure also should identify the amount of compensation received under such arrangements and its significance in the service provider's total revenues in that line of

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<sup>33</sup> See *Staff Report Concerning Examinations of Select Pension Consultants*, Office of Compliance Inspections and Examinations, SEC (May 16, 2005).

<sup>34</sup> See, e.g., *In the Matter of Callan Assoc.*, File No. 3-12808 (Sep. 19, 2007).

<sup>35</sup> See *Private Pensions: Increased Reliance*, *supra* note 3.

business.<sup>36</sup> For too long, fiduciaries have been kept in the dark about their advisers' incentives to recommend service providers based on compensation paid to the adviser, rather than on the best interests of the plan.

Conflicts of interest also are of concern in the context of investment decisions made by plan beneficiaries. Advisers to 401(k) beneficiaries are permitted, subject to their fiduciary duty to their clients, to receive compensation from sponsors of products that the adviser recommends ("distribution compensation"). In limited circumstances, distribution compensation can be higher for one product than another, which creates a conflict between the interests of the adviser and the 401(k) beneficiary, as the adviser has an economic incentive to recommend the product that pays him the greatest compensation, even if it is not the best product for the beneficiary. The cleanest and best way to deal with such conflicts, in my view, is to eliminate them by prohibiting the receipt of differential compensation by advisers of 401(k) plan beneficiaries. Absent such a ban, fee disclosure for 401(k) plans should inform beneficiaries of the existence of any conflict of interest created by differential compensation so that they can evaluate the objectivity and quality of the advice provided.

Distribution compensation generally is paid out of other fees that already will have been disclosed to beneficiaries. This means that disclosure of the amount of distribution compensation is not needed to inform investors about the total cost of investing (although it would tell them how their fees were allocated among different services). Rather, disclosure of the existence and extent of the conflict is needed to inform beneficiaries about advisers' financial incentives.<sup>37</sup>

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<sup>36</sup> Although EBSA's pending Form 5500 proposal would require some disclosure regarding such arrangements, the disclosure would not be required as to plans with fewer than 100 participants and it would not apply directly to service providers. See *Annual Reporting and Disclosure*, 71 Fed. Reg. 41392 (July 21, 2006).

<sup>37</sup> See *Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds*, Investment Company Act Rel. No. 26341, at Part II (Jan. 29, 2004) (explaining conflicts of interest necessitating requirement for point-of-sale of distribution compensation disclosure).

Advisers should be required to prominently disclose the extent to which their compensation may vary based on the investment options selected by the beneficiary. In order to qualify as "prominent," the disclosure should be in separate document, email message or web page. The disclosure must be provided separately because otherwise it is likely to be confused with fee disclosure that is designed to highlight the costs of investing, rather than the economic incentives of the adviser.<sup>38</sup> The disclosure should focus on the amount of the adviser's differential compensation in order to permit the beneficiary to evaluate the objectivity of the adviser's recommendations.

Moreover, differential compensation disclosure should be provided before the beneficiary makes the decision to retain the adviser so that the beneficiary can evaluate the adviser's services before soliciting recommendations. After the beneficiary has retained the adviser and received the adviser's recommendations, the opportunity to evaluate the wisdom of retaining that adviser will have passed. In this respect, Congress should require that, in addition to disclosure made prior to the retention of the adviser, the adviser specifically disclose any differential compensation received in connection with the recommended investments at the time that the recommendation is made. Finally, periodic reminders should be provided to beneficiaries as long as differential compensation payments continue.

Some may argue that disclosure of differential compensation is too costly and complex. Advisers who choose to create the conflict of interest that differential compensation disclosure would address, however, should not be allowed to avoid disclosure of differential compensation because of the complexity and disclosure costs they are responsible for creating. If, for example, a mutual fund charged dozens of different fees that depended on an investor's particular situation, the fund's sponsor should not be heard to complain that the cost of fee disclosure far exceeded its benefits. In short, the cost of fee disclosure should be viewed not as a reason to permit conflicts of

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<sup>38</sup> See Investment Advisers Act Rule 206(4)-3 (requiring disclosure of solicitor's capacity and compensation in a separate document).

interest to be concealed, but as a natural market constraint on inefficient pricing practices. To the extent that investors reject complex fee structures, such as differential compensation arrangements, when they are fully disclosed, fee disclosure should be viewed as having operated successfully by promoting informed investor choice, competition and efficiency.<sup>39</sup>

### COMPARATIVE FEE INFORMATION

As noted above, it is critical that the disclosure of 401(k) fees be accompanied by comparative fee information. The disclosure of fees accomplishes little when it is presented in a vacuum because few investors can readily assess whether the fees charged are high or low relative to the services provided or the fees charged by comparable investments. Mutual fund investment performance information is required to be compared to the performance of a comparable market index, because regulations recognize the importance of putting performance in context (although this has the effect of overemphasizing the significance of past performance), but funds are not required to do the same for fees. Providing comparative fee information makes even more sense than providing comparative investment performance information, because past fees (unlike past performance) are strongly predictive of future fees. Furthermore, fee comparisons are more valid than performance comparisons, because fees of different 401(k) plans generally will be more comparable than investment performance across different investment options.

Putting fee information in context by providing comparative information is important for a number of reasons. First, comparative information would promote competition among investment option providers and place downward pressure on fees. Second, comparative information would enable beneficiaries to evaluate the costs and

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<sup>39</sup> Although the speciousness of arguments that fee disclosure is too costly due to its complexity is most applicable to differential compensation arrangements, it is not limited to such arrangements. The same analysis applies to all types of complex fee arrangements, such as the use of different types of account and activity charges that are in addition to a fund's expense ratio and plan expenses as disclosed in the Form 5500.

benefits of investing in the 401(k) plan relative to other taxable and tax-deferred investment options.<sup>40</sup> Third, fiduciaries' interests may conflict with beneficiaries' with respect to the negotiation of 401(k) fees, as fiduciaries may be able to lower the administrative costs paid by the employer by shifting them onto plan beneficiaries in the form of asset-based fees.

Investment Option Fees. Without the context of comparative fee disclosure, the disclosure of an investment option's expense ratio is of limited utility because it only conveys the fact that an investment option and the plan are not free.<sup>41</sup> Standing alone, the fees provide little basis for evaluating whether they are reasonable in light of the services provided. The disclosure of comparative fee information would provide beneficiaries with a general sense of whether an investment option is more or less expensive than its peers and increase the likelihood that beneficiaries will think about whether above-average-cost options are worth the price. Also, providing average cost information for comparable investments should increase the likelihood that beneficiaries will make appropriate cost comparisons – for example, comparing a bond fund's fees to average bond fund fees rather than to fees for an actively managed stock fund – rather than simply comparing costs among various investment options with very different investment characteristics and choosing the cheapest option.

Providing comparative fee information to beneficiaries would promote competition among investment option providers for several reasons. First, providing this information should help incentivize employers, who are primarily responsible for the selection of investment options, to choose a plan with lower investment costs. Second, many 401(k) plans offer multiple investment options with overlapping asset or style categories. In this context, beneficiaries' investment decisions constitute a secondary

<sup>40</sup> In theory, comparative disclosure would enable employees to compare employers based on the relative qualities of their 401(k) plans. This potential benefit is secondary, however, to the benefits of promoting competition among investment option providers and facilitating an informed comparison of 401(k) and non-401(k) investment options.

<sup>41</sup> The AARP survey suggests, however, that many beneficiaries may actually be unaware that they pay any fees in connection with their 401(k) plans. See *supra* text accompanying note 14.

marketplace (the plan itself) within which investment option providers compete for assets. This marketplace is recreated in every plan with multiple investment options, which has the effect of combining the market power of investment decisions by beneficiaries across many plans. Even if fiduciaries fail to populate plans with low-cost investment options, beneficiaries will tend to move assets to lower cost providers, if the comparative cost of different options is prominently disclosed. Such intra-plan dynamics will promote competition and place downward pressure on fees.

**Plan Fees.** Even when a plan does not offer overlapping investment options, and comparative fee information therefore does not facilitate the comparison of different options,<sup>42</sup> comparative fee information would enable beneficiaries to make informed comparisons between 401(k) and non-401(k) investment vehicles. The axiom that employees should “max out their 401(k)” before investing elsewhere is no longer always valid advice<sup>43</sup> because employees will sometimes be able to achieve superior long-term, after-tax investment returns in other contexts. The proliferation of tax-deferred investment vehicles, many of which are designed, like 401(k) plans, for retirement planning, has provided numerous investment alternatives that offer tax advantages that are comparable to those offered by 401(k) plans. The historically low level of capital gains taxes relative to income taxes means that capital gains in 401(k) plans are taxed at higher income rates when distributed than are capital gains in taxable accounts when they are distributed.<sup>44</sup> Tax-managed funds, index funds and exchange-traded funds employ strategies that minimize taxes, thereby substantially minimizing their tax disadvantage

<sup>42</sup> In this context, comparative fee information would allow beneficiaries to appreciate that, for example, an international stock fund charged higher fees than a domestic stock fund, but I believe that the comparison among different investment categories should be based on beneficiaries’ overall investment objectives, not their relative expenses. Comparisons of fees for investment options with different investment objectives may mislead beneficiaries by confusing the primary basis on which comparisons across different options should be made. Comparisons between actively and passively managed investment options, however, would yield significant benefits, and the Department should consider mandating such comparisons.

<sup>43</sup> In contrast, the related axiom that employees should always “max out their 401(k) match” (*i.e.*, fully exploit matching employer contributions) still holds.

<sup>44</sup> To some extent, this taxable account advantage is reduced because capital gains taxes are paid on an ongoing basis, whereas income taxes on 401(k) capital gains are not paid until distributions from the account are made. Legislation has been proposed (and is slowly gaining support), however, that would permit the deferral of taxation of capital gain distributions by mutual funds that are reinvested in the funds.



relative to 401(k) plans. Thus, non-401(k) tax-advantaged investment vehicles, lower capital gains rates, and tax-minimizing investment vehicles mean that an employee will often be better off investing in a taxable account rather than a high-cost 401(k) plan (assuming no employer match). Fee disclosure for 401(k) plans should facilitate fee comparisons with non-401(k) investment vehicles.

Potential Conflicts of Interest. It is particularly important that comparative fee information be placed in the hands of beneficiaries who may have a stronger economic incentive than fiduciaries to reduce fees because it is primarily beneficiaries who pay them. In some cases, beneficiaries' and fiduciaries' interests can conflict. Fiduciaries may have an incentive to choose high-cost investment options as a means of shifting expenses from the employer to the beneficiaries. Plan fiduciaries therefore may be conflicted, because they have an incentive to reduce plan expenses (*i.e.*, expenses incurred by their employer) in return for accepting higher investment option expenses. Plan fiduciaries also may wish to be perceived as having successfully negotiated a low-cost administrative contract, or may simply be unaware of the trade-off between higher cost investment options and lower cost administrative services. Although fiduciaries generally will be more financially sophisticated than the average beneficiary, this is not always the case. Ultimately, beneficiaries have stronger economic incentives to uncover such tradeoffs. It takes only a single, activist beneficiary, armed with the appropriate information, to bring these issues to the attention of plan fiduciaries.

Form of Comparative Fee Information. Comparative fee information should be provided in the fee table for each investment option. The comparative expense ratio row should show average expense ratios for the investment option, and for total expenses, including investment and plan-level expenses charged as a percentage of assets (*see* Exhibit A). These data should be presented in a manner that ensures that they are easily distinguishable from, and readily comparable to, the plan's actual expense ratios. Congress should direct the Department of Labor to consider whether additional comparative information should be provided, such as the amount of the difference between each average expense ratio and the actual expense ratio or a graphic illustration

of each investment option's expenses relative to the average.<sup>45</sup> In making such decisions, both about content and format, the Department should consult with disclosure experts to help design disclosures that maximize beneficiaries' ability to understand key fee information.

Congress should authorize the Department to permit employers to use a variety of sources for comparative data, provided that the information is provided by an independent third party. The Department may, however, need to establish guidelines regarding what constitutes appropriate comparative data for different types of investment. The Department also should permit employers to use average plan-level expense ratios that reflect the size of the plan, subject to Department guidelines.

### COST ISSUES

Regarding which parties should bear the cost of providing fee information, I believe that Congress generally should leave the allocation of disclosure costs to the marketplace. Each of the three principal providers of information to 401(k) beneficiaries – employers, plan administrators and investment option sponsors – has sufficient negotiating power to ensure that markets work efficiently to find the optimal allocation of costs among the different parties. For example, I recommend that beneficiaries' quarterly statements include uniform dollar fee disclosure, which would require the calculation of the dollar amount of fees that would have been paid by a hypothetical \$1,000 account. If the annual cost of producing that information were \$1.00 for the investment option sponsor, \$1.05 for the administrator, and \$1.10 for the employer, then one would expect the cost ultimately to be allocated to the investment option sponsor as the lowest-cost provider. Formally "allocating" the cost to the administrator, for example, would simply result in the administrator's paying the investment option sponsor to provide the information at lower cost, with the only economic difference being the added cost of

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<sup>45</sup> Cf. *Are Hidden 401(k) Fees Undermining Retirement Security?* hearing before the Committee on Education and Labor, U.S. House of Representatives (Mar. 6, 2007) (statement of Stephen Butler) (proposing requirement to disclose opportunity cost of fees as measured by the amount by which an account would be reduced by fees during a 10- or 20-year period).

negotiating the transfer of this responsibility from the administrator to the investment option sponsor.

Thus, allocating costs by rule will not change the ultimate allocation of costs, but it can be expected to increase total costs to the extent that the rule does not choose the most efficient information provider. In a competitive 401(k) market, all costs ultimately will be borne by the lowest-cost provider, because structures that allocate costs to higher-cost providers will lose market share to more efficient, lower-cost competitors.

Another aspect of cost allocation is the allocation of costs across different employers. The greatest risk of implementing new fee disclosure requirements is that they will increase the cost of 401(k) plans for small employers to the point that they will choose not to offer the plan at all. The Committee should urge the Department to be sensitive to these relative cost burdens for small plans and to seek ways to minimize them, including by identifying disclosure and other requirements that could be modified or eliminated in order to reduce 401(k) expenses.

Finally, Congress should pay particular attention to the relative costs and benefits of fee disclosure reform, while keeping in mind that, to a great extent, a cost-benefit analysis of fee disclosure requirements must be based on economic principles rather than hard dollar analysis. The exact dollar amount of the benefit of fee disclosure simply cannot be measured, because there is no way to determine the total reduction in expenses that will result from greater fee transparency and standardization. I believe that the benefits of fee disclosure reform will substantially outweigh the costs based on the economic principle that price transparency promotes competition and reduces expenses. There is substantial evidence that investors are not sufficiently price sensitive, and enhanced price transparency, price standardization and comparative information should provide a powerful stimulus toward lowering the overall cost of investing by increasing price sensitivity. The steady migration of mutual fund investors to lower-cost mutual funds is partly, if not substantially, attributable to the high level of fee transparency

mandated by the securities laws. I believe that fee disclosure reform will generate substantial net economic benefits to 401(k) participants.

### CONCLUSION

Investment expenses represent a significant drag on the performance of 401(k) accounts that can be substantially mitigated through well-designed fee disclosure requirements. Although it is possible for an enterprising beneficiary to determine the total cost of his or her 401(k) plan's investment options and to find comparative fee information to place those costs in context, it requires enormous effort that only a tiny number of beneficiaries are likely to make. Fee disclosure reform is premised on the failure of many beneficiaries to be sufficiently sensitive to the impact of fees on their investment returns. Fee disclosure should therefore be designed to proactively direct fee-insensitive beneficiaries' attention to fees in order to stimulate competitive market forces and thereby reduce beneficiaries' expenses. I strongly support the Committee's goal of ensuring efficient, proactive 401(k) fee disclosure as a means to enhance the retirement security of tens of millions of Americans.

## EXHIBIT A

Fee table:

Investment Option	Fund Expenses	Total Plan Expenses	Illustrative Annual Fee Paid on \$1,000 Balance
Stock Fund	0.80%	1.00%	\$10.00
<i>Industry Average</i>	<i>0.70%</i>	<i>0.88%</i>	<i>\$8.80</i>
Bond Fund	0.50%	0.70%	\$7.00
<i>Industry Average</i>	<i>0.45%</i>	<i>0.63%</i>	<i>\$6.30</i>
Balanced Fund	0.65%	0.85%	\$8.50
<i>Industry Average</i>	<i>0.60%</i>	<i>0.78%</i>	<i>\$7.80</i>

Additional Expenses:

Small Account Fee: \$2.50/quarter

Redemption Fee: 1.00%

The CHAIRMAN. We thank you, Mr. Bullard. We are going to recess the hearing now. We will be back as soon as we can. We ask for your forbearance and your indulgence.

Senator SMITH. We apologize. I have always complained that the leadership never checks with the aging Committee when they schedule votes.

The CHAIRMAN. There are two votes, so we are not sure how they will fall. But we will be back just as soon as we can be here. Thank you. [Recess]

We will reconvene now, and we have our third witness. Mr. Kiley from Wisconsin, we will take your testimony.

Mr. Kiley.

**STATEMENT OF MICHAEL KILEY, PRESIDENT, PLAN  
ADMINISTRATORS, INC., DE PERE, WI**

Mr. KILEY. Good morning. My name is Michael Kiley. I am the founder and CEO of Plan Administrators, Inc., based in De Pere, WI. My firm is a two-time winner of the U.S. Chamber Blue Ribbon Small Business award, is a national provider of retirement plan services to thousands of small businesses throughout the country and their employees.

I am here today on behalf of the Council of Independent 401(k) Record Keepers, which is an organization of independent retirement plan service providers. The members of CIKR provide services for over 70,000 retirement plans covering three million participants with approximately \$130 billion in retirement assets.

CIKR is a subsidiary of the American Society of Pension Professionals and Actuaries, which has thousands of individual members nationwide. I would like to thank Chairman Kohl, Senator Smith and the other members of this Committee for examining the important issue of 401(k) plan fee disclosure.

As an independent service provider, my firm fully supports and actively practices full fee disclosure. The 401(k) plan industry delivers investments and services to plan sponsors and their participants using two primary business models, commonly known as bundled and unbundled.

Generally, bundled providers are large financial services companies whose primary business is manufacturing and selling investments. They bundle their proprietary investment products with affiliate-provided plan services into a package that is sold to plan sponsors.

By contrast, unbundled, or independent providers, are primarily in the business of offering retirement plan services. They will couple such services with a universe of unaffiliated, nonproprietary investment alternatives.

Whether a firm is a bundled investment firm or an unbundled independent, the full scope of services offered to plans and their participants is relatively the same. In other words, the only real difference to the plan sponsor is whether the services are provided by just one firm or more than one firm.

When a business owner wants to provide a retirement plan for their workers, they need to find someone to operate the plan and someone to provide the investments. Under ERISA, the business

owner must follow prudent practices and procedures when choosing the providers for each of these services.

This prudent evaluation should include an apples-to-apples comparison of services provided and the costs for those services. The only way to determine if a fee for a service is reasonable is to compare it to the fees charged by other service providers.

The retirement security of employees is completely dependent on the business owner's choice of retirement plan service providers. If the business owner chooses a plan with unreasonably high fees, the workers' retirement income will be severely impacted. It is imperative that the business owner have the best information to make the best choice.

The Department of Labor has proposed rules that would require enhanced disclosures on unbundled or independent service providers while exempting the bundled providers from doing the same thing. While we appreciate DOL's interest in addressing fee disclosure, we do not believe that any exemption for a specific business model type is in the best interest of plan sponsors or their participants.

Without uniform disclosure, plan sponsors will have to choose between a single price model and a fully disclosed business model that will not permit them to appropriately compare other provider services and fees. Knowing only the total cost will not permit plan sponsors, particularly less sophisticated small business owners, to evaluate whether certain plan services are sensible and reasonably priced.

In addition, if a breakdown of fees is not disclosed, plan sponsors will not be able to evaluate the reasonableness of fees as participant account balances grow. Take for example a \$1 million plan serviced by a bundled provider that is only required to disclose a total fee of 125 basis points, or \$12,500. If that plan grows to \$2 million—we hope it does—the fee doubles to \$25,000 although the level of plan services and the cost of providing such services have generally remained the same.

The bundled providers want an exemption while demanding that unbundled providers be forced to adhere to disclosure rules and regulations. Simply put, they want to be able to say that they can offer retirement plan services for free while we are required to disclose the fees for the same services.

Of course, there is no free lunch, and there is no such thing as a free 401(k) plan. In reality, the costs of these free plan services are being shifted to participants without their knowledge. The uniform disclosure of fees is the only way that plan sponsors can effectively evaluate the retirement plan services they offer to their workers.

To show it can be done, attached to my written testimony is a sample of how a uniform plan fiduciary disclosure could look by breaking plan fees into only three simple categories—investment management, record keeping and administration, and selling cost and advisory fees, we believe plan sponsors will have the information they need to satisfy their ERISA duties and their duties to their workers.

The private retirement system in our country is the best in the world. Competition has forced innovations in investments and service delivery.

However, important changes are still needed to ensure that the retirement system in America remains robust and effective into the future. By enabling competition and supporting plan sponsors, the uniform disclosure of fees and services, American workers will have a better chance at building retirement assets and living the American dream.

Thank you.

[The prepared statement of Mr. Kiley follows:]





**Statement by Michael Kiley,  
President/CEO of Plan Administrators, Inc.  
on behalf of  
ASPPA and CIKR**

**Comments Presented to the  
Special Committee on Aging  
United States Senate**

**Hearing on Plan Fee Disclosure**

October 24, 2007

Chairman Kohl, Senator Smith, and other distinguished members of the Committee, my name is Michael Kiley. In 1983 I founded and am currently President/CEO of Plan Administrators, Inc. (PAI), based in De Pere, Wisconsin. I made a commitment to get involved in the retirement plan industry when my father, Raymond J. Kiley, a decorated combat veteran of the Pacific Theatre in World War II, was poorly treated by his employer's pension plan. My commitment was to simplify retirement plans so that no one suffered the same fate as my father. Many people in the retirement industry just "find" themselves there – I've wanted to do this since I was 15 years old. My company provides retirement plan recordkeeping and administration services to more than ten thousand small and medium-sized 401(k) plans throughout the country. I am here today on behalf of the American Society of Pension Professionals & Actuaries (ASPPA) and the Council of Independent 401(k) Recordkeepers (CIKR).

ASPPA and CIKR thank you for this opportunity to address the important issues inherent in fee disclosure legislation. We applaud you for holding this hearing and for your leadership in addressing these issues that are so vital to the millions of Americans saving for retirement through their employer-sponsored 401(k), 403(b) and/or 457 plans.

ASPPA is a national organization of more than 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. ASPPA's large and broad-based membership gives ASPPA unusual insight into current practical problems with ERISA and qualified retirement plans, with a particular focus on the issues faced by small to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the private retirement plan system.

CIKR is a national organization of 401(k) plan service providers. CIKR members are unique in that they are primarily in the business of providing retirement plan services as compared to larger financial services companies that primarily are in the business of selling investments and investment products. As a consequence, the independent members of CIKR, many of whom are small businesses, make available to plan sponsors and participants a wide variety of investment alternatives from various financial services companies without bias or inherent conflicts of interest. By focusing their businesses on efficient retirement plan operations and innovative plan sponsor and participant services, CIKR members are a significant and important segment of the retirement plan service provider marketplace. Collectively, the members of CIKR provide services to approximately 3 million participants in 70,000 plans holding in excess of \$130 billion in assets.

Specifically, we very much appreciate the bill on 401(k) plan fee disclosure introduced this week by Chairman Kohl (D-WI) and Senator Harkin (D-IA). In particular, ASPPA and CIKR strongly support this committee's interest in improving the transparency of 401(k) fee and expense information at both the plan fiduciary and plan participant levels. We support the bill's even-handed application of its new disclosure rules to all service plan providers, regardless of their business structure. We also appreciate the more balanced approach taken in the bill on participant disclosures as compared to similar bills that have been introduced by the House of Representatives.

While you continue to consider legislation on 401(k) plan fee disclosure, we encourage you to strike the right balance between disclosure information appropriate for plan sponsors versus plan participants, which should differ for good reasons that I will enumerate below. To demonstrate that both of these goals can be accomplished, attached to this written testimony are two sample fee disclosure forms for your consideration—one for plan fiduciaries and another for plan participants. Each is tailored to provide plan fiduciaries and plan participants with the different sets of fee information that is needed to make informed decisions.

ASPPA and CIKR share your concern about ensuring plans and plan participants have the information they need—in a form that is both uniform and useful—to make informed decisions about how to invest their retirement savings plan contributions. This information is critical to millions of Americans' ability to invest in a way that will maximize their retirement savings so that they can achieve adequate retirement security. We support your efforts to examine these issues and we are grateful for the opportunity to express our experience and views.

## **Need for Uniform Disclosure to Plan Fiduciaries**

### ***Overview of the 401(k) Plan Marketplace***

There are currently no rules governing the disclosure of fees charged by plan service providers, and thus disclosure is generally inconsistent and too often nonexistent. ASPPA and CIKR generally support requiring plan service providers to disclose fees that will be charged to assist plan fiduciaries in fulfilling their responsibility to assess the reasonableness of such fees. Such a requirement is included in the bill introduced by Chairman Kohl and Senator Harkin, which requires the disclosure to plan fiduciaries of a description of the plan services to be provided, the expected costs of particular categories of services, and the identity of the

service provider or providers. H.R. 3185 also requires the explicit disclosure of certain conflicts of interest.

ASPPA and CIKR strongly believe that any disclosures required of service provider fees to a plan fiduciary must be provided in a uniform manner, regardless of how plan services are delivered. There are generally two main methods for delivering retirement plan services—"bundled" and "unbundled."

- Bundled providers are primarily in the business of selling investments and package their own proprietary investments with recordkeeping, administration and other retirement plan services. They typically are large financial services companies, such as mutual funds and insurers.
- Unbundled providers are primarily in the business of providing retirement plan operations and services and will offer such services along with a menu of independent, unaffiliated investment options, often referred to as an "open architecture" platform of investments. Although there are some larger unbundled providers, the vast majority of them are smaller businesses serving the unique needs of their small business clients.

Although they use very different business models, both bundled and unbundled providers deliver the same kind of plan services to plan sponsors and participants.

Bundled and unbundled providers, however, do collect their fees in different ways. In general, a bundled provider collects its fees from plan assets. In the case of a mutual fund, for example, fees are collected in the form of the "expense ratio" assessed against the particular investment options chosen by participants, reducing their rate of return for the year.<sup>1</sup> In the case of an insurance company, the fee can also be in the form of a percentage fee assessed against total plan assets referred to in the industry as a "wrap fee." In either case, fees collected by bundled providers are generally always charged against participants' accounts. Because the plan sponsor is not paying a fee for services directly to the service provider, bundled providers will present the plan to the plan sponsor as having "free" recordkeeping and administration. There is currently little to no disclosure of this to either plan sponsors or plan participants. There are literally tens of thousands of 401(k) plans that report zero costs for recordkeeping and administration on their annual report (Form 5500) filed with the Department of Labor. In actuality, participant accounts are being charged for these "free" plan services in the form of investment fees assessed against their accounts.

Unbundled providers, by contrast, generally collect fees for the services they provide in two ways—by revenue sharing from the company providing the plan's investment options and by a direct charge to the plan and/or plan sponsor, depending on the willingness of the plan sponsor to bear such costs. A portion of the expense ratios for the plan's investment options includes a component for recordkeeping and administration.<sup>2</sup> Since an unbundled provider, not an investment company, is performing recordkeeping and administration, the investment company will typically pass on a portion of the expense ratio to the unbundled provider as compensation for performing such services. This is commonly known in the industry as

<sup>1</sup> A mutual fund prospectus provides more detail of what is contained in an expense ratio, which includes the cost for recordkeeping, as well as promotional costs (*i.e.*, Rule 12b-1 fees).

<sup>2</sup> As discussed earlier, this will be explained in more detail in the investment prospectus.

revenue sharing. Depending on the size of the plan and the willingness of the plan sponsor to pay directly for retirement plan services, the amount of revenue sharing may be used to offset what would otherwise be charged directly to the plan and/or plan sponsor for recordkeeping and administration. Since the unbundled provider usually receives revenue sharing from an investment company on an omnibus basis (for all plans serviced by the provider but not on a per plan basis), the unbundled provider must employ a reasonable method, usually based on plan assets, for allocating the revenue sharing it receives to each plan for which it provides services.

***Complete and Uniform Disclosure is Necessary to Determine "Reasonableness" of Fees***

A central point of contention is the position the Department of Labor (DOL) took in proposed Form 5500 regulations, which would exempt bundled service providers from certain fee disclosure requirements applicable to unbundled/independent service providers. Specifically, in the proposed 2009 Form 5500, payments received by service providers from third parties (even though not from plan assets) would need to be disclosed. So, for example, allocable revenue sharing payments received by a third party administrator (TPA) for recordkeeping and administration in connection with the plan would need to be disclosed on the form. However, the regulation would exempt bundled providers from this disclosure requirement, with the result being that bundled providers would not have to disclose comparable internal revenue sharing payments to the affiliated entity or division providing recordkeeping and administration services.<sup>3</sup>

To satisfy their ERISA-imposed fiduciary duty, plan fiduciaries must determine that the fees charged for recordkeeping, administration and other plan services are "reasonable," requiring a comparison to fees charged by other providers, both bundled and unbundled. Inconsistent disclosure requirements between bundled versus unbundled providers will lead to a distorted analysis by plan fiduciaries as they review 401(k) plan fees. For instance, it will be virtually impossible for plan fiduciaries to determine the true costs for plan services provided through a bundled arrangement, which, as noted earlier, are often presented as having no cost. Uniform fee disclosures are needed for plan fiduciaries to make an "apples to apples" comparison of fees for various plan services offered by competing providers.

A breakdown of fees for various plan services will also allow plan fiduciaries to evaluate whether all the various plan services are really needed. The fee assessed by a bundled provider is akin to a "prix fixe" menu at a restaurant. There is only one price for the package and usually no choice about which services are included. Without any reasonable segregation of the costs for plan services, less sophisticated plan fiduciaries, such as small business owners, may not appreciate the fact that the bundled package includes services they may not want or yet need—services they may be paying for under a single "bundled" price arrangement. With this information, plan fiduciaries will be in the position to question the necessity and cost of some of the services, potentially leading to lower costs to the plan and participants.

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<sup>3</sup> The DOL will also soon propose regulations under ERISA §408(b)(2) that will require retirement plan service providers to disclose expected fees to plan fiduciaries at "point of sale." It is expected that the rules will be comparable to the disclosures required in the Form 5500 when finalized.

Plan fiduciaries also need a reasonable breakdown of fees for various services so they can continue to monitor the reasonableness of fees as a plan grows and costs increase. For example, assume a plan with assets valued at \$1 million being service by a bundled provider for an "all-in" price of 125 basis points or \$12,500. If, through growth of the company and increases in the market value of assets, plan assets grew to \$2 million, the fee would be \$25,000. However, without any reasonable allocation of fees to services, such as recordkeeping and administration, the plan fiduciary will not be in a position to ask why the fee has doubled even though the level of services has remained essentially the same.

Disclosure of conflicts of interest is also critical. It should not be presumed that plan fiduciaries and participants, particularly those at small businesses, recognize and understand inherent conflicts of interest and their potential impact. A bundled provider will naturally prefer to sell a packaged 401(k) plan with only its own proprietary investments, as opposed to one with investments provided by other financial services companies, since in the former case it will retain all the fees. We believe the bill introduced by Chairman Kohl and Senator Harkin appropriately addresses conflicts of interest.

Exempting bundled providers from 401(k) plan fee disclosure rules will also greatly interfere with an extremely competitive 401(k) plan marketplace. Enhanced transparency requirements that only apply to unbundled arrangements may make them appear to have higher fees even though the total fees to the plan may in fact be similar, or perhaps even less. Similarly, a provider that has the ability to offer both proprietary investments and investments managed by unrelated investment managers will have an even greater advantage marketing its proprietary investments, because the cost of an arrangement of primarily proprietary investments will appear to be lower than that of an arrangement comprised of primarily independent investments. Small business plan sponsors with less sophistication will be more susceptible to these misperceptions in fee disclosure. Not only does this have the potential for creating a competitive imbalance in the service provider marketplace; even worse, it sets up the possibility that small business plan sponsors will lose an opportunity to choose a plan that will better serve their workers' retirement planning needs.

The bundled providers specifically argue against being subject to a uniform set of disclosure requirements by stating that it would be too expensive to break down the internal or affiliate-provided service costs. They further suggest that any such breakdown would be inherently artificial since any internal cost allocations are merely for budgeting and accounting purposes. The bundled providers also argue that any conflicts of interest between a service provider and its affiliates should be readily apparent to the plan fiduciary.

ASPPA and CIKR respectfully disagree with the position of the bundled providers. We believe it is possible with very little cost to develop an allocation methodology to provide a reasonable breakdown of fees for plan services. We discuss in more detail below how such a simplified breakdown of plan fees could be presented to plan fiduciaries. We note that it is the position of the bundled providers that unbundled providers—their competitors—should disclose such a breakdown of fees along with their allocation methodology, while they should be exempt.<sup>4</sup> As noted earlier, since unbundled providers received revenue sharing on an omnibus basis, not on a per plan basis, such an allocation will be necessary and we believe

<sup>4</sup> See Testimony of Mary Podesta on behalf of the Investment Company Institute before the ERISA Advisory Council Working Group on Fiduciary Responsibilities and Revenue Sharing Practices (Sept. 20, 2007).

can be reasonably accomplished.<sup>5</sup> We find it ironic that the bundled providers, all large financial institutions, suggest that unbundled providers, mostly small businesses, be required to do something that they apparently are incapable of doing. Fundamentally, we believe the position of the bundled providers is an attempt to get a competitive advantage through law and/or regulation. Simply put, they want to be able to tell plan sponsors that they can offer retirement plan services for free while unbundled providers are required to disclose the fees for the same services.

ASPPA and CIKR strongly believe that any disclosure requirements should apply uniformly to all service providers, as provided in the legislation introduced by Chairman Kohl and Senator Harkin. Importantly, the bill would require a breakdown of fees that will allow plan fiduciaries to assess the reasonableness of fees by comparison to other providers and will also allow fiduciaries to determine whether certain services are needed, leading to potentially even lower fees.

It is also worthy of note that bundled service providers do provide a breakdown of fees for various plan services to their larger plan clients—clients who have the negotiating power to ask for this detailed cost information. Less sophisticated small businesses without access to this information will not appreciate the conflicts of interest and will be steered toward “prix fixe” packages that include services for which they may not need to pay. Uniform and consistent disclosure, regardless of how plan services are delivered, is necessary to ensure a level playing field and an efficient marketplace, ultimately leading to more competitive fees benefiting both plan sponsors and participants.

### ***Suggested Plan Fiduciary Disclosure Requirements***

Participants are totally dependent on the plan fiduciary's decision making process and have to manage their retirement assets based on the plan that has been chosen for them. The retirement income of participants will be severely impacted if fees charged are unnecessarily high. That is why the disclosure made to plan fiduciaries is so critically important.

A fee disclosure bill should require an annual disclosure from service providers of all fees and conflicts of interest to employers sponsoring 401(k) plans. Plan fiduciaries should not be allowed to enter into a contract with a service provider unless the service provider provides a written annual statement identifying who will be performing services for the plan, a description of each service, the total cost for plan services provided under the contract, and a reasonable allocation of the total cost attributable to the significant categories of plan services. In addition, to address potential conflicts of interest, disclosure should be made to the extent the contracting service provider makes payments to or receives payments from affiliates or third-parties in connection with services or investments provided to the plan. In other words, the rules of disclosure would be the same regardless of whether the services are provided on a “bundled” or “unbundled” basis. We support the legislation introduced by Chairman Kohl and Senator Harkin for following these principles:

In order to make the service provider disclosure more user-friendly for plan fiduciaries, we would recommend a more simplified service provider fee disclosure that will break down the fees for all services under the following components:

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<sup>5</sup> An allocation on the basis of the value of plan assets is one possible allocation method.

- (1) Investment Management Expenses
- (2) Administrative and Recordkeeping Fees, and
- (3) Selling Costs and Advisory Fees.

All fees charged to 401(k) plans can be allocated to one of these components, and we would suggest that any further breakdown might be unnecessarily confusing to plan fiduciaries. These component expenses would be disclosed under three categories based on how they are collected—as fees on investments, fees on total plan assets, and fees paid directly by the plan sponsor. We also support a requirement that there be a conflicts-of-interest statement disclosing any conflicts, as noted above. To demonstrate that a simplified disclosure form can be achieved, we have attached to this testimony a sample form for the Committee to review and consider.

ASPPA and CIKR will strongly support legislation, such as the bill introduced by Chairman Kohl and Senator Harkin, that includes these required disclosures, equally applicable to all plan service providers, regardless of their business structure (*i.e.*, whether bundled or unbundled). The requirement that service providers disclose fees on a uniform basis will ensure a level playing field in an extremely competitive marketplace. That would be good news for plan participants' retirement asset accumulation needs and goals.

## Need for Sensible and Understandable Disclosure to Plan Participants

### Overview

The level of detail in the information needed by 401(k) plan participants differs considerably than that needed by plan fiduciaries. Plan participants need clear and complete information on the investment choices available to them through their 401(k) plan, and other factors that will affect their account balance. In particular, participants who self-direct their 401(k) investments must be able to view and understand the investment performance and fee information charged directly to their 401(k) accounts in order to evaluate the investments offered by the plan and decide whether they want to engage in certain plan transactions.

The disclosure of investment fee information is particularly important because of the significant impact these fees have on the adequacy of the participant's retirement savings. In general, investment management fees (which can include investment-specific wrap fees, redemption fees and redemption charges) constitute the majority of fees charged to 401(k) participants' accounts and therefore have a significant impact on a participant's retirement security.<sup>6</sup> For example, over a 25-year period, a participant paying only 0.5% per year in plan expenses will net an additional 28% in retirement plan income over a participant in a similar plan bearing 1.5% in participant plan expenses per year. ASPPA and CIKR strongly support a requirement that plan sponsors disclose to plan participants, in a uniform, readily understandable format, all the information *that the participant needs* to make an informed choice among the investment options offered to them.

There are currently no uniform rules on how this information is disclosed to plan participants by the various service providers. As stated in GAO Report 07-21, this is in large part due to

<sup>6</sup> GAO Report 07-21 cited a 2005 industry survey estimating that investment fees made up about 80 to 99 percent of plan fees, depending on the number of participants in the plan.

the fact that ERISA requires limited disclosure by plan sponsors and does not require disclosure in a uniform way, which does not foster an easy comparison of investment options. Furthermore, the various types of investments offered in a 401(k) plan (e.g., mutual funds, annuities, brokerage windows, pooled separate accounts, collective trusts, etc.) are directly regulated by separate Federal and State agencies and are not likely to have uniform disclosure rules anytime soon.

401(k) plan participants—as lay investors—generally do not have easy access to fee and expense information about their 401(k) investment options outside of the information that is provided by their plan sponsor and service provider. Further, while the existence of disclosure materials is a significant issue, accessibility and clarity of disclosure are equally compelling concerns. If the information is buried within page upon page of technical language, it is effectively unavailable to participants. If it is provided in an obvious manner, but the structure of the information is such that a participant cannot understand it or compare it to similar information for an alternate investment, it is also effectively unavailable. Therefore, insufficient or overly complicated information will often result in delayed or permanently deferred enrollment, investment inertia and irrational allocations.

It is all too easy to overwhelm plan participants with details they simply do not need, and in many cases do not want. And an overwhelmed participant is more likely to simply ignore all the basic and necessary information that he or she does need to make a wise investment decision, or worse, to simply decline to participate in the plan. Thus, it is critical that the amount and format of information required to be disclosed to plan participants be well balanced to include all the information participants need, but no more than the information they need. To do otherwise risks putting participants in a position of simply declining to participate in the retirement plan, or making arbitrary—and potentially adverse—allocations of their retirement contributions.

Further, there is a cost to any disclosure. And that cost is most often borne by the plan participants themselves. To incur costs of disclosure of information that will not be relevant to most participants will unnecessarily depress the participants' ability to accumulate retirement savings within their 401(k) plans. Thus, appropriate disclosure must be cost-effective, too. The result of mandatory disclosure should be the provision of all the information the plan participant needs, and no more. To require otherwise would unjustifiably, through increased costs, reduce participants' retirement savings. Those participants who want to delve further into the mechanics and mathematics of the fees associated with their investment choices and other potential account fees should have the absolute right to request additional information—it should be readily available on a Web site, or upon participant request. This will take care of those participants who feel they need more detailed information.

### ***Suggested Plan Participant Disclosure Requirements***

To give participants the information they need, ASPPA and CIKR recommend that plan sponsors provide to plan participants upon enrollment and annually thereafter information about direct fees and expenses related to investment options under their 401(k) plan, as well as other charges that could be assessed against their account. This mandatory disclosure must be in an understandable format that includes sufficient flexibility to enable various types of potential fees to be disclosed within the context of uniform rules. This simple, uniform, carefully crafted disclosure would allow participants to make more informed decisions



regarding their 401(k) accounts by allowing them to simply compare the various fees and expenses charged for each investment option, and by making them aware of the possible other fees they can incur depending on the decisions they make.

To accomplish this objective, ASPPA and CIKR strongly support a requirement that an exemplary "fee menu" be provided to plan participants upon enrollment, and annually thereafter, that would provide a snapshot of the direct fees and expenses that could potentially be charged against a participant's account. This plan-level forward-looking "fee menu" would provide participants at enrollment and at the beginning of the year a summary of all the fees (including investment specific fees, account-based fees and transaction costs) that could be assessed against the account. The plan fiduciary would be responsible for ensuring that the "fee menu" disclosure document is made available to the participants, but generally would obtain the necessary fee data (and in most cases, the disclosure form itself) from the plan's service provider.

For the Committee's consideration, ASPPA and CIKR have developed a sample fee menu (attached to this testimony) that we believe would contain, in a clear and simple format, all the information a plan participant would need to make informed decisions about his or her plan. It is consistent with the recommendations ASPPA and CIKR provided to the DOL on July 20, 2007, in response to their request for information (RFI) regarding fee and expense to disclosures in individual account plans.

ASPPA and CIKR also support the concept of providing "after-the-fact" information on the investment alternatives so that plan participants can consider the relevant investment return information, along with the effect of fees on each investment, when deciding whether the options they have selected remain appropriate. Since the proposed fee menu would provide participants with detailed information of any potential fees that could be charged to their accounts, the "after-the-fact" information should be limited to gross return and net return after fees on each investment alternative. Providing information in this manner would reduce costs and provide participants with relevant and understandable information that would allow them to make an informed comparison of each investment option without overwhelming them with too much detail that they do not need.

Accordingly, ASPPA and CIKR recommend that the "after-the-fact" disclosure be limited to the gross and net return of each investment alternative. We believe such disclosures will provide participants with well-balanced and understandable information to decide on the investments appropriate for them, while helping to ultimately reduce costs for the plan participants who will likely pay for these additional disclosures.

### **DOL Regulatory Initiatives**

It has been suggested by some that Congress should wait until the DOL concludes its currently ongoing regulatory project on new fee disclosure requirements. These initiatives include: (1) a modification to Schedule C of the 2009 Form 5500; (2) guidance on what constitutes "reasonable" compensation under ERISA §408(b)(2) between service providers and plan fiduciaries; and (3) increased disclosure requirements under ERISA §404(c). ASPPA and CIKR believe that while the DOL guidance on this issue is a very important factor in Congress' decision on 401(k) fee disclosure requirements, it is ultimately the right and responsibility of the Congress to make the determination whether more fee disclosure is required, and if so, its appropriate scope and frequency.

Further, the DOL's jurisdiction over fee disclosure issues may be limited to the voluntary ERISA §404(c) plans that are subject to the DOL's disclosure rule-making. Arguably, plans that are not operating under the voluntary 404(c) liability protections would also not be subject to the DOL's fee disclosure requirements. Guidance applicable only to 404(c) plans would be an unfortunate result that could harm those participants whose employers sponsor non-404(c) plans.

ASPPA and CIKR recommend that the Senate proceed with this inquiry, and with appropriate legislation, regardless of the current status of the DOL regulatory effort. It will not be too late to modify either the legislation or the regulatory guidance if and when either initiative reaches a stage in the process where it would be appropriate to defer one to the other.

### **All Self-Directed Account Plans Should Be Included**

This testimony and much of the conversation about the fee disclosure issue focuses on 401(k) plans. However, the issues are identical for 403(b) and 457 plans, and indeed for any and all self-directed account retirement plans. Technical details, which can be addressed in the drafting of legislative language, will differ to some degree in applying full, fair, uniform, and clear disclosure of fees and expenses rules to these plans. But the need for these rules is every bit as acute for 403(b) and 457 plans as it is for 401(k) plans. Accordingly, ASPPA and CIKR recommend that fee disclosure legislation apply to all self-directed account pension plans.

### **Summary**

In summary, ASPPA and CIKR applaud this committee for its leadership on the important issue of required 401(k) fee/expense disclosure. We support complete and consistent disclosure requirements to both plan fiduciaries and plan participants, as reflected in the bill introduced by Chairman Kohl and Senator Harkin. We believe that any new disclosure requirements to plan fiduciaries should apply uniformly to all service providers, regardless of the form of their business structure (*i.e.*, "bundled" or "unbundled"). Respecting plan participant disclosures, ASPPA and CIKR fully support a forward-looking annual "fee menu" being provided annually to plan participants in a simple, concise format so that they can make an informed evaluation of all the potential fees that could affect their accounts. To further these objectives, we have provided a sample disclosure form for use by plan service providers to plan sponsors, and a sample fee menu form for plan participants.

Again, thank you for this opportunity to testify on these important issues. ASPPA and CIKR pledge to you our full support in creating the best possible fee disclosure rules. I will be happy to answer any questions you may have.

Attachments: Sample fee disclosure form (plan sponsors)  
Sample fee menu (plan participants)

The CHAIRMAN. Thank you, Mr. Kiley.  
Mr. Chambers.

**STATEMENT OF ROBERT CHAMBERS, CHAIRMAN, AMERICAN  
BENEFITS COUNCIL, CHARLOTTE, NC**

Mr. CHAMBERS. Thank you, Chairman Kohl.

My name is Robert Chambers. As indicated previously, I am in the Charlotte, North Carolina-based law firm of Helms Mulliss & Wicker. I am also the Chairman of the Board of the American Benefits Council this year, which is one of the organizations on whose behalf I am testifying today. The others are the American Council of Life Insurers and the Investment Company Institute.

All three organizations very much appreciate the opportunity to present testimony with respect to 401(k) plan fees. Our goal, like yours, is that the 401(k) system remain fair and equitable, that it function in a transparent manner, and that it provide meaningful benefits at a fair price.

Our members have been successful in obtaining fee information and using it to sponsor less expensive and more efficient 401(k) programs. Yet, at the same time we think there is room for improvement through more universal disclosure of fee and other information to both fiduciaries and to plan participants.

There are three pieces of the fee disclosure puzzle that we have been discussing today. One is disclosure by service providers to employers and to other fiduciaries. The other is disclosure by fiduciaries to plan participants. Finally, disclosure by fiduciaries to the government.

This comports, as we heard, with the GAO's recommendations in their 2006 report, and with the three-part project that the Department of Labor is currently pursuing, and about which we heard in the last panel.

Admittedly, we as these three organizations on whose behalf I am testifying today may have some concerns with some of the details in the department's proposals when they are issued. Frankly, we usually do, but we absolutely agree with their general approach.

Now, I would like to use the remaining portion of my time to raise five points that the Council, ACLI and ICI think that require your attention.

First, the 401(k) system in the United States is voluntary. It depends on the willingness of employers to you—to offer plans and the willingness of employees to use them. Fee disclosure reform does not—must not undermine these basic building blocks.

If a new regiment is overly complicated or overly costly, or if it may lead to increased employer liability, some employers are going to drop their plans. Others are going to comply, but they may pass the costs on to participants in the form of plan expenses or reduced employer contributions.

Further, and most important, many employees will be confused by the over-emphasis on fees when compared to equally valuable investment considerations, such as diversification, investment objectives, actual investment performance and risk and return factors, and they will make either unbalanced investment decisions or, even worse, a decision not to participate at all. Investment education is based on balance, and neither Congress, the Department

of Labor nor plan fiduciaries should counteract this concept through a disproportionate focus on plan fees.

Second, every new feature that is added to a 401(k) plan adds new cost. Some of these enhancements are mandatory, such as the new benefit statement rules, and others, such as automatic enrollment, are permissive. But all of them are enhancements. They have all been adopted by Congress, and they all cost money to administer.

Additional fee disclosure will result in additional cost. The legislature and regulatory agencies must coordinate their efforts when improving fee disclosure rules. Gearing up to comply with one new set of disclosure rules is going to be expensive, but shifting to another set of rules shortly thereafter will be enormously expensive and confusing to both plan fiduciaries and participants.

Remember, these costs will need to be absorbed by participants and plan sponsors. Many sponsors could accommodate these increased costs by reducing plan contributions, as I previously noted, resulting in smaller benefits for participants. Therefore, we must measure carefully the value of what may be gained against the cost of annual disclosure. It will be particularly poor stewardship if our collective efforts to reduce costs in the end actually reduce savings.

Third, in our system of commerce, it is quality and features of a product or a service that permit one manufacturer or service provider to charge more than a competitor. Some cars cost more than others, as do computers and wine. Similarly, 401(k) plan fees should not be evaluated independently from the product or service that is provided.

If asked, every participant would be willing to pay higher fees if the total net return on the investment is increased. Enhanced disclosure will enable participants to determine whether the quality of the product or the provider warrants its costs. The two are inextricably tied to each other.

Fourth, we acknowledge that fee levels differ among different plans, just like cable TV service. Some people want only basic service. Some employers provide only a basic 401(k) plan. But other viewers want hundreds of channels, providing they expect an even more expansive spectrum of entertainment. Many employers want to provide a similarly broad span of retirement plan features for their participants.

I know I have just a few seconds left. May I beg your indulgence just for one more point after this? Thank you.

Many employers want to provide a similarly broad span of retirement plan features for their participants. More features, more costs. Enhanced disclosure will help employers to decide which choices to make available and will help participants to make decisions among the choices presented. It is also true that many smaller employers pay comparatively higher 401(k) fees. This is usually attributable to fewer lives over which to amortize fixed costs.

We believe that increased disclosure will exert downward pressure on fee levels in the marketplace. While it may not increase the negotiating power of smaller employers, it is going to provide them with a better shopping opportunity.

Finally, fee information should be disclosed in the manner in which fees are charged, and this is where I think there is some dis-

agreement on the panel. As you know, some services are bundled together and some are sold separately.

Certainly, service providers must disclose the services that they provide and the costs of those services. But they should also be permitted to distinguish between those services that are bundled together and those services that the plan fiduciary may purchase separately. This is particularly important when ascribing fees to those services.

Specifically, a service provider should not be required to ascribe separate fees to services that are not sold separately. For example, if a plan record-keeper has a captive trust company, how the fees are split internally is of no significance to, and may actually confuse a plan fiduciary where the fiduciary is not able to purchase those services separately at that price. Further, the split may be proprietary information, and may not accurately reflect other aspects of the relationship between the group of the bundled service providers.

So, in conclusion, we are very supportive of enhanced disclosure of plan fees, but fee disclosure must be addressed in a way that does not over-emphasize fees relative to other factors in the investment decisionmaking process, or undermine confidence in the retirement system or create new costs, which could result in decreased retirement benefits.

Thank you.

[The prepared statement of Mr. Chambers follows:]



**TESTIMONY OF ROBERT G. CHAMBERS**

**ON BEHALF OF**

**AMERICAN BENEFITS COUNCIL  
AND  
AMERICAN COUNCIL OF LIFE INSURERS  
AND  
INVESTMENT COMPANY INSTITUTE**

**BEFORE THE**

**SENATE SPECIAL COMMITTEE ON AGING**

**FOR THE HEARING**

**on**

**HIDDEN 401(k) FEES: HOW DISCLOSURE CAN  
INCREASE RETIREMENT SECURITY**

**WEDNESDAY, OCTOBER 24, 2007**

### **Introduction.**

My name is Robert G. Chambers and I am a partner in the Charlotte, North Carolina law firm of Helms Mulliss & Wicker. I have advised clients with respect to 401(k) plan issues since 401(k) was added to the Internal Revenue Code in 1978. In that regard, my clients have included both major employers that sponsor 401(k) plans as well as national financial institutions that provide services to 401(k) plans. I am also chair of the board of the American Benefits Council ("Council"), which is one of the organizations on whose behalf I am testifying today. I am also testifying today on behalf of the American Council of Life Insurers ("ACLI") and the Investment Company Institute ("ICI").

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The ACLI represents 373 member companies accounting for 93 percent of the life insurance industry's total assets in the United States. Life insurers are among the country's leaders in providing retirement security to American workers, providing a wide variety of group annuities and other products, both to achieve competitive returns while retirement savings are accumulating and to provide guaranteed income past retirement.

ICI is the national association of U.S. investment companies, which manage about half of 401(k) and IRA assets. ICI advocates policies to make retirement savings more effective and secure.

The Council, the ACLI, and ICI very much appreciate the opportunity to present testimony with respect to 401(k) plan fees. With the decline of the defined benefit plan system, 401(k) plans have become the primary retirement plan for millions of Americans. Accordingly, it is more important than ever for all of us to take appropriate steps to ensure that 401(k) plans provide those Americans with retirement security. Our goal is an effective 401(k) system that functions in a transparent manner and provides meaningful benefits at a fair price in terms of fees. At the same time, we all must bear in mind that unnecessary burdens and cost imposed on these plans will slow their growth and reduce participants' benefits, thus undermining the very purpose of the plans.

### **We Support Enhanced Disclosure And Reporting Requirements.**

With respect to 401(k) plan fees, we believe that this Committee would be pleased by what our member companies are doing. Our members - - both plan

sponsors and service providers -- report to us that plan fiduciaries are taking extensive steps to ensure that fee levels are fair and reasonable for their participants. Plan fiduciaries are asking hard questions regarding the various plan services and fees, and service providers are providing fiduciaries with answers that give them the tools to negotiate effectively for lower fees and to provide meaningful information to participants. In the case of small plans with less bargaining power, plan fiduciaries are using additional fee information from service providers to shop more effectively.

Are there exceptions to this rosy picture? Of course there are. No system functions perfectly. So we need to strive to make the system even better. How can we achieve those improvements? The answer is conceptually simple: through even more universal disclosure of meaningful information. We need to ensure that all plan fiduciaries and service providers follow the practices we are hearing about from our members. Those practices include disclosure to plan fiduciaries of direct and indirect fees that service providers receive from the plan or from unrelated third parties. Those practices also include clear, meaningful disclosure to participants.

In this regard, we commend the Department of Labor and the Government Accountability Office ("GAO"). The Department of Labor has been working on a three-part project to enhance transparency that is conceptually the same as the enhanced regime we are recommending. This three-part approach is very similar to the recommendations made by GAO. One part would require the type of disclosure by service providers to plan fiduciaries that I refer to above. A second part would require clear, meaningful disclosure to participants. And a third part would require plans to report fee information to the Department. We may have concerns regarding certain specific points with respect to the Department's proposals, but conceptually we are in agreement with the general approach. We believe that the Department is addressing the key policy issues that have been raised regarding fee transparency, and we look forward to a constructive dialogue with the Department as its proposals move forward.

As described in its letter to GAO regarding plan fees, the Department of Labor has already taken a number of steps to improve awareness and understanding with respect to plan fees. The Department makes available on its website important materials designed to help participants and plan fiduciaries understand plan fees. These materials include "A Look at 401(k) Plan Fees for Employees", which is designed to assist participants in understanding plan fees and selecting investment options. For employers and other plan fiduciaries, the Department makes available "Understanding Retirement Plan Fees and Expenses", "Tips for Selecting and Monitoring Service Providers for Your Employee Benefit Plan", and "Selecting and Monitoring Pension Consultants - Tips for Plan Fiduciaries". In addition, the Department makes available a model form -- called the "401(k) Plan Fee Disclosure Form" -- that is designed to facilitate both the disclosure of plan fees by service providers to plan fiduciaries and the comparison of these fees. Finally, the Department conducts educational programs across the country that are designed to educate plan fiduciaries about their duties.



In short, we believe that the Department of Labor and GAO have been making, and continue to make, important contributions to improving the 401(k) plan system. We are also proud of our own efforts to improve fee disclosure, which include working in a constructive manner with the Department to help it improve disclosure and transparency. In 2006, a group of associations submitted to the Department an extensive list of fee and expense data elements that plan sponsors can use to discuss fees effectively with their service providers. The associations were the American Benefits Council, the Investment Company Institute, the American Council of Life Insurers, the American Bankers Association, and the Securities Industry Association (now the Securities Industry and Financial Markets Association). In addition, these same organizations recently submitted joint recommendations to the Department in response to its Request for Information regarding fee disclosures to participants; the following organizations also joined in making these recommendations: the Committee on Investment of Employee Benefit Assets, The ERISA Industry Committee, the Profit Sharing/401k Council of America, the National Association of Manufacturers, the U.S. Chamber of Commerce, the Financial Services Roundtable, and the Society for Human Resource Management. We view disclosure enhancement as a critical part of our mission to strengthen the 401(k) plan system.

#### Coordination Of Legislative And Regulatory Processes.

To reiterate, we support improvement to the rules regarding plan fee disclosure. Effective plan fee disclosure to participants will provide them with an opportunity to understand their options and choose the investments best suited to their circumstances. Disclosure to plan fiduciaries equips fiduciaries to negotiate and shop for the best services at reasonable prices. In addition, clarity with respect to both sets of rules can provide plan fiduciaries with a means of helping their participants without liability.

In the effort to improve the fee disclosure rules, we believe that it is very important that the legislative and regulatory processes be coordinated. For example, it would be very harmful for participants, plan sponsors, and providers for one set of rules to apply for a year or two, only to be supplanted by a different set of rules. The additional programming and data collection costs caused by such a scenario would be enormous, not to mention the resulting confusion among participants and plan fiduciaries. Such costs would, of necessity, generally be absorbed by plan participants and to some extent by plan sponsors. However, many plan sponsors could react to increased costs by reducing contributions and possibly even eliminating or failing to adopt plans; plan participants would simply receive smaller benefits, which would be unfortunate.

Accordingly, we urge both Congress and the Department to consider how best to coordinate their efforts to avoid adverse consequences.

### **Addressing Concerns And Questions.**

So far, we have been focusing on positive things that can be done to improve the 401(k) plan system. Now we would like to touch on certain concerns and answer some questions that have been raised.

### **We Must Not Undermine The Voluntary System.**

The success of the 401(k) plan system is dependent on many things, including very notably the willingness of employers to offer these plans and the willingness of employees to participate in the plans. It is critical that any reform efforts not inadvertently undermine these key building blocks of our system. Clear, meaningful disclosure is needed; overly complicated and burdensome disclosures would only push employers and service providers away from the 401(k) plan system. In particular, burdensome rules would be yet another powerful disincentive for small employers to maintain plans. Overly complicated disclosure would also confuse rather than inform participants; participants need clear meaningful information that is relevant to their decision-making.

In addition, employee confidence is critical to their participation in the system. If the millions of employees participating in well-run efficient 401(k) plans hear only about 401(k) plan problems and do not hear about the strengths of the system and if they are given overly complex disclosures, their confidence will be eroded, their participation will decline, and their retirement security will be undermined.

### **We Must Not Inadvertently Increase Fees In The Effort To Reduce Them.**

Every new requirement imposed on the 401(k) plan system has a cost. And generally it is participants who bear that cost. So it would be unfortunate and counterproductive if a plethora of new complicated rules are added in an effort to reduce costs, but the expense of administering those new rules actually ends up adding to those costs. The Department of Labor has explicitly raised this concern. In its letter to GAO regarding the GAO plan fee report, the Department noted that its own fee disclosure project must be designed "without imposing undue compliance costs, given that any such costs are likely to be charged against the individual accounts of participants and affect their retirement savings."

It is important to recognize a key point noted in the GAO report. In the course of numerous plan fee investigations conducted by the Department of Labor in the late 1990's, no ERISA violations were found with respect to 401(k) plan fees. Moreover, the Department of Labor receives enforcement referrals from various entities, such as federal and state agencies. The GAO report notes that "only one of the referrals that the [Department of Labor] has closed over the past 5 years was directly related to fees" (emphasis added). In the context of these facts -- clear attention by the Department to

fees but very little evidence of violations - - imposing burdensome new rules and costs to be borne by participants would be even less justified and, in fact, would be counterintuitive.

This discussion leads logically to three points. First, any new requirement should not be added unless it provides material assistance to plan participants or fiduciaries. Second, any new requirement should be structured in such a way as not to add unnecessary costs. Third, as new requirements are added, we must seize the opportunity to streamline the rules by revisiting the need for old requirements that may be out of date or rendered unnecessary by the new rules.

#### **Disclosure To Plan Participants.**

It is critical to emphasize that the disclosure rules should take into account the sharply different circumstances of participants and plan fiduciaries. Participants need clear, simple, short disclosures that effectively communicate the key points that they need to know to decide whether to participate and, if so, how to invest. The key pieces of information for participants include the investment objective, historical performance, risk, and fees and expenses. Excessive detail can prevent employees from reading or understanding the disclosure and can also serve to obscure key points. Plan fiduciaries need more detailed information since it is their duty to understand fully the options available and to make prudent choices on behalf of all of their participants.

#### **Fees Can Only Be Evaluated In The Context Of The Services Provided.**

We must avoid studying fees in a vacuum and we must avoid disclosure regimes that elevate fees over other issues of equal or greater importance to plans and their participants. Fees are very important, but they are only one component of performance; with respect to investments, other key components include risk and return characteristics, diversification, investment objective, and, of course, investment return. Our objective should be excellent performance and service at a fair price.

Accordingly, any specific fee should be evaluated in the context of the quality of the service or product that is being paid for. For example, some actively managed investment options may logically have higher than average expenses, but it is the net performance of the option that is critical to retirement plan sponsors and participants, not the fee component in isolation.

Another example of this point is that increased fees generally reflect increased services. In the past several decades, there has been enormous progress in the development of services and products available to defined contribution plans ("DC plans") such as 401(k) plans. For example, many years ago, plan assets generally were valued once per quarter - - or even once per year - - so that employees' accounts were generally not valued at the current market value. Participants generally were not

permitted to invest their assets in accordance with their own objectives; the plan fiduciary generally invested all plan assets together. Today, 401(k) plans generally value plan investments on a daily basis, and permit participants to control their accounts and make investment exchanges frequently (often on a daily basis) to achieve their own objectives. Other new services include, for example, internet access and voice response systems, on-line distribution and loan modeling, and on-line calculators for comparing deferral options.

In addition, the legal environment for DC plans used to be simpler, with far fewer legal requirements and design options. New legal requirements or options can require significant systems enhancements. For example, system modifications were needed to address catch-up contributions, automatic rollovers of distributions between \$1,000 and \$5,000, Roth 401(k) options, redemption fees and required holding periods with respect to plan investment options, employer stock diversification requirements, default investment notices, automatic enrollment, and new benefit statement rules.

Also, as noted in our Introduction above, 401(k) plans have become the dominant retirement vehicle for millions of American workers. With this change has come the need to help participants adequately plan for their retirement. Service providers have responded by developing investment advice offerings, retirement planning and education, programs to increase employee participation in plans, and plan distribution options that address a participant's retirement income and asset needs.

Naturally, the new services and products and the needed systems modifications have a cost. In this regard, we also want to emphasize that the disclosure rules need to be flexible enough to take into account the ever evolving 401(k) plan service market.

On a related point, we see enhanced plan fee disclosure as another important step with respect to participant education. And we look forward to working with this Committee on further participant education initiatives.

#### **Why Do Fee Levels Differ So Much Among Different Plans?**

Different workforces need different services. Accordingly, the 401(k) plan market has attracted a number of different service providers that have developed numerous service options for plans, often with different fee structures and different services available for separate fees. This structure avoids forcing plans to pay for services that they do not want or use, and increases the options available to plan sponsors wishing to find providers and services that meet their and their employees' unique needs.

Concerns have been raised about the higher level of fees for smaller plans. Many plan service costs vary only slightly (if at all) based on the number of participants in the plan. Accordingly, on a per-participant basis, plan costs can be higher for small plans

than for large plans. On a similar point, many costs do not vary with the size of a participant's account, so plans with small accounts will often pay higher fees -- on a percentage of assets basis -- than plans with large accounts. These effects are most often a function of the nature of the services rendered: for example, plans must meet the same regulatory requirements without regard to whether a plan has 100 participants or 100,000 participants, and without regard to whether the average account size is \$5,000 or \$50,000.

### **Who Pays DC Plan Fees?**

By law, the employer must pay certain fees, such as the cost of designing a plan. But there are a wide range of fees that are permitted to be paid by the plan and its participants, such as fees for investments, recordkeeping, trustee services, participant communications, investment advice or education, plan loans, compliance testing, and plan audits. Many employers voluntarily pay for certain expenses that could be charged to the plan and its participants, such as recordkeeping, administrative, auditing, and certain legal expenses. On the other hand, investment expenses, such as expenses of a particular mutual fund or other investment option, are generally borne by the participant whose account is invested in the fund.

### **Are Plan Fees Too High?**

Competition among investment options and service providers is intense, which exerts downward pressure on fee levels. For example, investment expenses are generally a significant portion of plan expenses. These expenses are reviewed in the context of reviewing the performance of investment options, since each option's performance is determined after expenses are netted out. Plans routinely review such performance: a 2006 survey by the Profit Sharing/401k Council of America indicates that 62% of plans review plan investments at least quarterly and substantially all plans conduct such a review at least annually.

In fact, plan investment fees are much lower than fees outside the context of plans. For example, a 2007 study by the Investment Company Institute found that in 2006 the average asset-weighted expense ratio for 401(k) plans investing in stock mutual funds was 0.74%, compared to a 0.88% average for all stock mutual funds.

### **Additional Principles With Respect To Plan Fee Issues.**

There has been a vigorous and informative public policy discussion over the last several months regarding plan fee issues. Based on that helpful discussion, we offer the following additional principles regarding modification of plan disclosure rules.

- Reform of existing rules regarding electronic communication is needed to facilitate less expensive, more efficient forms of communication, including the

use of internet and intranet postings. Consideration should be given to adopting rules at least as workable as the Internal Revenue Service's rules regarding electronic communication. Such rules ensure that electronic communications are only used with respect to participants who can access such communications; at the same time, the Service's rules are also generally workable for plans. Without the effective ability to use electronic communication, compliance with extensive new disclosure rules would be unreasonably costly and burdensome.

- **Where disclosure to participants of exact dollar amounts of fees would be costly, the use of estimates or examples based on prior year data should be permitted.** Disclosure of exact dollar amounts of fees to participants would be enormously costly in many instances. For example, for participants moving in and out of investment options all year, determining the precise dollar amount of fees charged for the year would require tremendous work as well as new recordkeeping systems. Very helpful fee information can be conveyed efficiently through the disclosure of expense ratios and reasonable estimates; the cost of turning those estimates into precise numbers would be very high and clearly not justified by the marginal difference between a reasonable estimate and the exact number.
- **Where disclosure of exact dollar amounts to plan fiduciaries would be costly, the disclosure of fee formulas to plan fiduciaries should be permitted.** As in the case of participant disclosure, disclosure of exact fee dollar amounts to plan fiduciaries could be extremely expensive in circumstances where fees are based on a percentage of assets. Plan fiduciaries only need the fee formula (such as the basis points charged); that will give them all the tools they need to evaluate the cost of the service. The high cost of calculating exact dollar amounts clearly outstrips the value of such exactitude.
- **If asset-based fees embedded in an investment option pay for other services, such as administrative services, this fact should be disclosed to plan fiduciaries and participants.**
- **Plan fiduciaries should retain flexibility to determine the format (as opposed to content) for disclosure based on the nature, expectations, and other attributes of their workforce.**
- **The rules must be flexible enough to accommodate the full range of possible investment options that are or may be used in 401(k) plans, including those providing a guaranteed rate of return based on the general assets of the provider.**

- **Fee information should be disclosed in the manner in which fees are charged.** Artificial division of a single "bundled" fee into components that are not commercially available separately at that cost serves no purpose. Service providers should be required to disclose what services are included in the "bundle" and what services can be purchased separately by the plan fiduciary. The rules should not require "unbundling the bundle", i.e., a service provider should not be required to ascribe separate fees to services that are not sold separately by the service provider. This is not meaningful information. It is burdensome and costly to produce; it may be proprietary information; it has no significance since the services cannot be purchased separately from the service provider; and accordingly, it would not further fiduciaries' understanding of their options.

Plan fiduciaries can reasonably make the decision whether to purchase services on a bundled or unbundled basis. Some fiduciaries believe, for example, that bundling provides economies of scale and facilitates efficient shopping for service providers, especially with respect to plans maintained by small employers. If the plan fiduciary understands the services that will be performed and the total cost of the service arrangement, it will be able to compare the overall cost and quantity of the bundled provider's offer with an unbundled arrangement available to the plan, and fulfill its responsibility to enter into reasonable service arrangements.

A plan fiduciary purchasing services on a bundled basis retains the duty to determine if (1) the bundled package of services is appropriate for the plan, and (2) the bundled price is reasonable, both initially and over time. This will require the plan fiduciary to monitor, for example, whether any asset-based fees continue to be reasonable, especially with respect to services that do not vary based on the size of the plan assets. Again, for some fiduciaries, those monitoring tasks may be simpler in the bundled context than where there are multiple providers with respect to a single plan.

- **Disclosure of revenue sharing received by plan service providers from third parties should be required.** Disclosure of the affiliation between two or more service providers should also be disclosed. However, payments from one service provider to another affiliated service provider are not revenue sharing and should not be required to be disclosed. Affiliates are part of one economic unit, so that any explicit payments between them may not reflect an arm's length transaction and thus may have little or no significance. Moreover, financial relationships between affiliates can be complex, including numerous non-market transactions, such as the exchange of services without any charges; in this context, calculating the value of "revenue sharing" would require identifying and valuing all of these non-market transactions and would thus be enormously difficult and uncertain.

In short, determining the value of intra-affiliated group payments would be costly and filled with speculation and uncertainty. Also, in light of the relationship between the entities, such payments are not revenue sharing in a true sense.

- **The rules should not require disclosure of transactions among service providers that are not directly related to the plan.** A large service provider with respect to a plan may enter into thousands of transactions with affiliated and unaffiliated companies, some of which may have unrelated dealings with the same plan. Disclosure of such transactional relationships would be enormously burdensome, as well as meaningless for the plan.
- **Fees paid by plan sponsors should not be subject to any of the disclosure rules.** Where plan assets are not involved, ERISA's rules are not implicated.
- **Fees charged by service providers to plans should be disclosed. Fees charged to service providers by their suppliers have no relevance to plans and should not be required to be disclosed.** The rules should not require disclosure of a service provider's transactions with its suppliers, of which there could be a huge number. These suppliers have no contractual relationship to the plan, so any requirement to disclose such suppliers would, in addition to being extremely burdensome, be meaningless for the plan.

#### Conclusion.

We are very supportive of enhanced disclosure of plan fees. But fee disclosure must be addressed in a way that does not undermine participant confidence in the retirement system and does not create new costs that have the counterproductive effect of increasing fees borne by participants. We are committed to working with the government to make improvements in the fee disclosure area. We believe that the best approach to the fee issue is through simple, clear disclosures that enable plan sponsors and participants to understand and compare fees in the context of the services and benefits being offered under the plan.



The CHAIRMAN. Thank you.

Mr. Chambers, you warn in your testimony, you just said that participants could be confused by an overly complicated disclosure of fees. My bill, along with Senator Harkin, would give one number to participants on their quarterly statement, with the option for them to request further information.

Do you think that giving participants a single fee number quarterly and allowing those that want to get further information is too complicated?

Mr. CHAMBERS. I think, Senator, the complication may be in coming up with one number for each participant. Clearly, from their perspective, if you give them one number, that is fine. It may be misleading for those people. It is not going to be comparative, as some of the other folks on this panel have suggested. I would be concerned that it would be giving them information in a vacuum.

Admittedly, clean, crisp, simple, but I am not sure that it is the information that they would need.

The CHAIRMAN. Mr. Bullard, do you think giving participants a single number to represent their fees on their quarterly statement with the option for more information would be overly confusing, or would you recommend that?

Mr. BULLARD. I would recommend it strongly, and I have heard arguments before that it might be misleading, which is always the argument that industry makes when, after having argued that we can't provide them with too much information because it will be too complex, once we winnow it down to some essential, simple information, it becomes misleading.

There is going to be a tradeoff, as Senator Smith suggested, and that tradeoff is going to be between comprehensive information and clear, simple information. A dollar disclosure, what they actually paid in fees, or very close estimate of that amount, will only have the effect, even if it is not a perfect representation of what they paid, of making them think harder about their fees. It begins to get the ball rolling.

One thing I think I agree with Mr. Chambers about. Is that more price transparency puts downward pressure on fees. I am a firm believer that that particular disclosure would do more to reduce the costs of investing in 401(k) plans than any other proposal that this Committee might adopt.

The CHAIRMAN. Do you think that Mr. Chambers is representing interests that wanted to have higher fees?

Mr. BULLARD. I think Mr. Chambers is representing an industry that has already expended large sums on compliance. Unfortunately, the debate is always about new regulations rather than looking at old ones in which the people he has represented have already invested a fair amount of capital.

I think the DOL should always be looking at how to reduce costs and eliminating old rules that are no longer important at the same time they are thinking about coming up with new rules.

But as far as the costs of quarterly statements goes, in the past the industry has argued, and I think I quoted in my testimony that the mutual fund industry said that it would be "breathhtakingly high." Within a year, MFS Investment Management announced

that it was going to be providing the same quarterly statement disclosure that the industry insisted was completely unaffordable.

So here is one provider that not only finds it affordable, but apparently believes it is profitable. I think that we need to move on and think about the behavioral effect it would have on people, if you could give them what I described as the \$225 versus \$37 disclosure.

I have no doubt that, even for the least sophisticated investor, that would put enormous downward pressure on fees.

The CHAIRMAN. To all the members of the panel, would you agree that it is really important that people enrolled in 401(k) plans know what the fee is? How we get there, whether it is difficult or easy, but it is very, very important that they know their fee? Anybody disagree with that?

Mr. CHAMBERS. I agree with that statement.

The CHAIRMAN. Bullard. Mr. Love.

Mr. LOVE. Certainly. Certainly agree with that.

Mr. KILEY. I guess I would probably say the test is whether they can name the expense ratio, their investment option charges—probably not. But I think what we are getting at here is that they are conscious of their fees and the impact that it has on their bottom line.

The CHAIRMAN. Right.

Mr. BULLARD. In fact, the expense ratio does not convey that. If you asked your average person, particularly one that is not that sensitive to fees, when they get into the checkout line, instead of them saying, "That will be \$12.50," they say, "That will be .2 percent of what you have got in your wallet." They will have no idea what you are talking about.

What we want people to understand is, it is a dollar number, so they can see they are getting these heavy hits on their balance quarter in and quarter out. It should represent a meaningful decision on the part of the plan to pay that amount of expense.

Mr. Chambers is absolutely right. Sometimes that \$225 versus \$37 will be explained by the fact it is a small plan, few participants, low balances, and a desire to have high-cost active funds.

But the fact is that having those numbers will drive that inquiry and put a lot of pressure in places where the market is not efficient.

The CHAIRMAN. Mr. Love, why is it that so few people do know what their fee is?

Mr. LOVE. I am afraid it is probably a matter of not having the information available to them. The larger issue of financial literacy is a problem in this country. People need to know more about how they invest, how they save for retirement.

If it were clearer to them, if there were charts, if there were single numbers, if there were dollar amounts, they would be much more likely to understand the consequences of the fees for their retirement. Right now it is not clear. It is not that they are being hidden. They are simply not clear.

The CHAIRMAN. Well, being as the fee differential can eventually mean so much in terms of the return on their 401(k), why is it that those people who administer the 401(k) plans don't make it more clear what the fee is?

Mr. LOVE. I am not sure of the answer to that. We are being—they can simply call for that. I mean, the actual plan participant who is asked, is this important to your consideration of your plan, always says yes. They would like to know what fees are when making decisions about investments. I am not sure why they are not clearer on the statements.

The CHAIRMAN. You think that most people don't have an awareness of what the differential can mean in terms of return on their investment if the fee is 2 percent, versus 1 percent, 1.5 percent? They don't really understand that.

Mr. CHAMBERS. They really don't understand that.

If you ask someone clearly a comparative math problem, is 1.5 percent more than .5 percent, most people can tell you yes, that is the case. But in our survey, a lot of people could not.

But on the other hand, if you say to a participant, "Here is a fund which charges 50 basis points a year, and here is a fund that charges 75 basis points a year," I think that most participants are going to understand one is more expensive than the other. But that is not the final analysis. The final analysis is, historically, how has this fund, charging fewer basis points, done compared to that fund which charges more?

But to go back to Mr. Love's point about financial education, I think that that is the crux. I think that what we are dealing with here in connection with plan fees is, if you will pardon the expression, the "low-hanging fruit" of the equation. I think that the bigger issue facing this country and, frankly, in my view, facing Congress, because this is where you really join the foray here, is to try to figure out ways to help the Department of Labor to help employers to focus on how they can provide better financial education to their participants.

Frankly, throwing more pieces of paper or more e-mails at different folks with a lot more information isn't going to get us over that hump. What is going to get us over that hump is more work similar to what the Department of Labor has done in the past, perhaps some tax opportunities for employees to get better financial information, which will then enable them to take the information that we are talking about today and put it to better use.

Mr. BULLARD. If I could just respond to two points, I would observe that using percentages, as Mr. Chambers just used, will simply not communicate the same information to those who are used to thinking about dollars.

Second, no one has suggested that it is the final answer. The idea is to give an impetus for the market to work where we think it is not working efficiently.

Third, the ultimate question is not really performance, when you get right down to it. Virtually every study has shown that there is minimal, if any, repetition, that is, persistence of performance among investment options. If you think about what Congress's concern should be, it should be looking at Americans as a whole.

The fact is if you look at all Americans investing in all stock funds, the return of that group is going to be the market's return. No matter how you cut it, if there is one fund that is doing better by buying good stocks that another fund shouldn't be selling, they

are buying the stocks from a fund. It is going to do worse than the market.

So the bottom line is, America's going to get the market return, regardless of all the emphasis that some would like to put on performance. The only question I think for this Committee is how much of that market return is going to be given up to service providers and Wall Street.

Mr. KILEY. Mr. Kohl, if I may, a couple of direct concerns that I would have.

Within the industry, I would offer that, practically speaking, the way that small plans are sold and scrutinized, there is generally someone within the mix who has an interest in all of the facts of a plan. So while we cannot get the attention of all 20 employees and get them to invest in the knowledge, those 20 employees in a small employer generally have a high degree of trust of someone in the equation, generally one of their coworkers, who really does scrutinize the vendor material quite closely.

So in that regard, by paying attention to that person that they find to be influential, they take an interest in the plan. I would submit that, as an industry, initiating a full, fair, level playing field on disclosure around fees will drive up interest in the area of concern, drive up interest in the fees. It will create downward pressure.

In the end, it will take away an argument that we hear time and time again. If we do not disclose fees and if we don't do a good job with it—and the market will fine-tune that as time goes by—there is a tendency on behalf of some people to assume the worst. So they will avoid getting into their 401(k) plan if they don't see what they see to be a very full, fair disclosure process.

So by engaging a full, fair disclosure process, over time we will bring ourselves more customers in this industry, which is what we are after.

The CHAIRMAN. Is there much disagreement on what we are hearing here today? Mr. Chambers, are you in any particular disagreement with the thrust of what the other three have said this morning?

Mr. CHAMBERS. I suspect that we agree on more than we disagree on, which is helpful and always surprising on panels of this sort. I think that certainly my focus, and the focus of the folks who I represent—who I would, by the way, point out are many employers, not just service providers, and therefore are not in it to maximize fees.

But I think that the focus that we are looking at is, as I mentioned, cost. There is significant additional cost in coming up with specific dollar amounts on a per-participant basis annually, quarterly, whatever the frequency is to be, and whether that cost, along with all the other costs that are associated with this, as I mentioned before, are actually going to wind up resulting in a net loss compared to where we would have been.

So we are interested in transparency. We are interested in providing additional information. I agree completely that employees, if provided with information and with education on how to use it, that they will do a better job, and they are more likely to participate to a greater extent.

I am not sure that I agree that the only way to do this is on dollars. I am not sure that I agree with some of the other things that we have said. But the positive note is that all four of us I think agree on more than we otherwise disagree on.

The CHAIRMAN. Any other comments, gentlemen?

It has been a good hearing, I think, on an important subject, and the Committee is going to continue to pursue improvements in the information that people who hold 401(k)s get with respect to fees and other charges. So, we appreciate your being here this morning, and you can expect to hear from us.

Mr. LOVE. Thank you.

Mr. CHAMBERS. Thank the Chair. Appreciate it.

The CHAIRMAN. Thank you so much. Thank you all for coming.

Senator SMITH. Thank you, Chairman.

[Whereupon, at 12 p.m., the Committee was adjourned.]

## APPENDIX

### PREPARED STATEMENT OF SENATOR ROBERT P. CASEY, JR.

I want to thank my colleague, Senator Kohl, for calling this important hearing. We meet today to discuss the issue of retirement security and particularly the role of 401(k) fee disclosure.

As life expectancy for Americans is increasing and with the baby boom generation approaches retirement the number of older Americans is increasing. Last year, there were more than 37 million Americans over the age of 65. My own state, Pennsylvania, has the third largest population of older citizens in the country—1.9 million and growing. We have a responsibility to ensure that all Americans have a secure retirement, and this is a particularly vital and acute issue for seniors.

Living longer, and living more years in retirement, requires depending more on personal retirement funds to cover expenses. We have a variety of incentives and vehicles that allow people to save for retirement over the course of their lifetime, and we need to improve our efforts in that area, but even those who are able to save over a long period of time are also dependent upon the return on their investment. That is why it is imperative that an individual receive complete information on the fees that will be charged. Many people don't realize it, but these fees can vary widely from plan to plan, and that variation costs people real money. Federal pension law does not currently mandate that plan sponsors provide information on fees, leaving many participants unaware of exactly what they are paying or how it compares with what other plans might charge. We often exhort people to make responsible decisions, but the truth is they can only do that when they have good information.

Both employers and employees need to be aware of all fees involved in the 401(k) plan a company offers. According to the AARP Public Policy Institute, over 80 percent of 401(k) participants report being unaware of the fees associated with their plans. This is a precarious situation that could leave many individuals with less money than they envisioned in retirement.

If we can ensure that employers and employees are provided this information in a clear and consistent matter we can do two things: we can let people better understand the different choices they face, and we can bring market pressure on these plans to lower fees and save our constituents money that would otherwise go to someone else. The idea of holding down fees on investments is not a new one and investment companies outside of 401(k) plans do compete on cost.

In 1975, John Bogle started the Vanguard Corporation which is based in Valley Forge, Pennsylvania. Pioneered the creation of index mutual funds. He created his index funds for a variety of reasons, one of them being the low costs he could pass on to his investors. To most people, it may sound like this hearing is just about a few percentage points difference, and that does not matter. But a few percentage points add up to real money over time. A \$10,000 investment that earns 10% per year over the course of 50 years, will compound to \$1,170,000. But a difference of just 2%, or an 8% return, will only compound to \$470,000. This two percentage point difference can cost someone \$700,000.

John Bogle and others noticed this a long time ago, but we have failed to ensure that investors can really compare the fees involved in their retirement investments. For many people 401(k)s are their only form of private retirement savings, and we have a responsibility to give them the tools to make it simple and easy to maximize their returns while minimizing their risk.

Thank you again, Mr. Chairman, for calling this important hearing. I look forward to examining it further both here in the Aging Committee, and also in the Banking Committee. We need must ensure individuals have complete information so their retirement years can be secure and productive.

## PREPARED STATEMENT OF SENATOR SUSAN COLLINS

The Chairman and the Ranking Member have performed a genuine public service in organizing this hearing on fee disclosure for 401(k) plan sponsors and participants.

As we all know, seemingly small differences in fees can make enormous differences in asset accumulation over the years. For example, the Congressional Research Service calculated this month that a middle-income family investing for three decades in a fund with a four-tenths of one percent cost ratio will have 35 percent more money then if they invested in an otherwise identical fund with a two percent cost ratio.

Now it is obviously true that a higher-cost fund can be worth its expense if it delivers top-notch results over the years. But even if a high-cost fund has an excellent net-of-costs return, it is also true—as fund prospectuses and advertisements warn us—that “Past performance is no guarantee of future results.”

In this context, it is troubling that researchers have found that the great majority of participants in 401(k) savings plan do not understand the impact that fees can have and do not know what fees are being assessed on their employer's plan and on their accounts. All too often, the same can be said of plan sponsors, especially smaller businesses that may not have the staff or the experience to consider cost factors in selecting and monitoring plan administrators.

As the new Government Accountability Office report on this issue concludes, “participants need information about the direct expenses that could be charged to their accounts,” while “plan sponsors...need additional information to fulfill their fiduciary responsibilities.”

But perhaps what is even more important is the clarity and quality of the information rather than the quantity of the information. Effective—as compared to voluminous—disclosures are a cornerstone for prudent decision-making by employers and their employees.

When we consider that more than 40 percent of private-sector employees participate in 401(k) plans and that government repeatedly stresses the importance of building personal savings to supplement Social Security, the inescapable conclusion is that we must ensure that workers and employers have access to understandable cost information for the funds that will provide for their retirement.

Having said that, I must inject a note of caution. In our attempt to provide greater clarity of information for participants and sponsors, we need to be careful not to overwhelm them with new and excessive information that confuses rather than clarifies. From my contacts with constituents and from my former experience as a state business regulation commissioner, I know all too well how often well-intended regulations can have unintended consequences.

I believe we would benefit, for example, from further study of the research and rulemaking that is currently underway at the Department of Labor before inadvertently creating unnecessary expense without necessarily improving the quality or clarity of 401(k) cost information. Adjustments and improvements to make the information already provided more useful and understandable could result in the most useful disclosure of all.

Mr. Chairman, I am confident that the testimony of today's witnesses will help us find a prudent path toward providing better information to 401(k) sponsors and participants without imposing burdensome requirements or risking information overload. Again, I applaud your and the Ranking Member's initiative in convening this hearing on a matter of great importance to working Americans.

## A PRIMER ON PLAN FEES

OCTOBER 18, 2007

AMERICAN BANKERS ASSOCIATION  
 COMMITTEE ON INVESTMENT OF EMPLOYEE BENEFIT ASSETS  
 THE ERISA INDUSTRY COMMITTEE  
 THE FINANCIAL SERVICES ROUNDTABLE  
 INVESTMENT ADVISER ASSOCIATION  
 INVESTMENT COMPANY INSTITUTE  
 NATIONAL ASSOCIATION OF MANUFACTURERS  
 PROFIT SHARING/401k COUNCIL OF AMERICA  
 SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION  
 SOCIETY FOR HUMAN RESOURCE MANAGEMENT  
 UNITED STATES CHAMBER OF COMMERCE

### **INTRODUCTION**

ERISA provides many safeguards for the protection of workers' retirement assets. Plan assets must be held in a trust that is separate from the employer's assets. The fiduciary of the trust (normally the employer or committee within the employer) must operate the trust for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. In other words, the fiduciary has a duty under ERISA to ensure that any expenses of operating the plan, to the extent they are paid with plan assets, are reasonable.

### **PLAN FEES**

As Congress examines retirement plan fees, it is critically important that policymakers have accurate information regarding such fees. The vast majority of participants in ERISA plans have access to capital markets at lower cost through their plans than the participants could obtain in the retail markets because of economies of scale and the fiduciary's role in selecting investments and monitoring fees. The level of fees paid among all ERISA plan participants will vary considerably, however, based on variables that include plan size (in dollars and/or number of participants), participant account balances, asset mix, and the types of investments and the level of services being provided. Below is data from surveys conducted by various organizations that monitor and analyze plan fees. The studies reflect, in particular, the impact of plan size and average account balances on fees:

**CEM Benchmarking Inc.** — CEM is a benchmarking company that serves 300 of the world's largest public and corporate pension plans in the US, Canada, Europe and Australia. A study of 88 US defined contribution plans with total assets of \$512 billion (ranging from \$4 million to over \$10 billion per plan) and 8.3 million participants (ranging from fewer than



1,000 to over 100,000 per plan) found that **total costs ranged from 6 to 154 basis points<sup>1</sup> (bps)** of plan assets in 2005. Total costs varied with overall plan size. Plans with assets in excess of \$10 billion averaged 28 bps while plans between \$0.5 billion and \$2.0 billion averaged 52 bps. Further, costs depended on the average account balance. Plans with an average account balance less than \$55,000 paid four bps more in administrative compliance costs than plans with an average account balance exceeding \$55,000. Total costs were also affected significantly by asset mix. Costs rose as the proportion of plan assets invested in domestic small cap stock and alternative investments (i.e., real estate) increased. In a separate analysis conducted for the Profit Sharing / 401k Council of America, **CEM reported that, in 2005, its private sector corporate plans had total average costs of 33.4 bps and median costs of 29.8 bps.**

**HR Investment Consultants** — HR Investment Consultants is a consulting firm providing a wide range of services to employers offering participant-directed retirement plans. It publishes the **401(k) Averages Book** that contains plan fee benchmarking data. The 2007 edition of the book reveals that **average total plan costs ranged from 159 bps for plans with 25 participants to 107 bps for plans with 5,000 participants.**

**Committee on Investment of Employee Benefit Assets (CIEBA)** - CIEBA is the voice of the Association of Financial Professionals (AFP) on employee benefit plan asset management and investment issues. CIEBA represents more than 115 of the country's largest pension/retirement funds. Its members manage \$1.4 trillion in defined benefit and defined contribution plan assets, on behalf of 16 million (defined benefit and defined contribution) plan participants and beneficiaries. A 2005 survey of 109 CIEBA members revealed that **plan costs paid by defined contribution plan participants averaged 22 bps.**

#### ***DEPARTMENT OF LABOR FEE TRANSPARENCY INITIATIVES***

Fee disclosure and transparency present complex issues. Amending ERISA through legislation to prescribe specific fee disclosure will lock in disclosure standards built around today's practices and could discourage product and service innovation. The Department of Labor (DOL) has announced a series of regulatory initiatives that will make significant improvements to fee disclosure and transparency. **The undersigned support the DOL's efforts. We believe that this is the best approach to enhance fee transparency in a measured and balanced manner and we urge Congress to delay taking legislative action until the Department of Labor has completed its work.** The DOL's initiatives are as follows:

**Annual Reporting Requirements** Among the new impending fee disclosure obligations are revised annual reporting requirements for plan sponsors. DOL is about to finalize modifications to the Form 5500 and the accompanying Schedule C, on which sponsors report compensation paid to plan service providers. The modifications will expand the number of service providers that must be listed and impose new requirements to report service provider revenue-sharing. The final regulations implementing the new Form 5500 are expected in the very near future and are expected to first be applicable to the 2009 plan year.

**Service Provider Disclosure Obligations** DOL also intends later this year to issue a revised regulation under ERISA Section 408(b)(2), which is a statutory rule dictating that a plan may pay no more than reasonable compensation to plan service providers. The expected proposal

<sup>1</sup> One basis point is one-hundredth of one percent — 100 basis points equals one percent.

is designed to ensure that plan fiduciaries have access to information about all forms and sources of compensation that service providers receive (including revenue-sharing). Both sponsors and providers will be subject to new legal requirements under these proposed rules, including an anticipated requirement that all third party compensation be disclosed in contracts or other service provider agreements with the plan sponsor.

**Participant Disclosure Rules** The DOL's remaining initiative focuses on revamping participant-level disclosure of defined contribution plan fees. DOL issued a Request for Information ("RFI") in April 2007 seeking comment on the current state of fee disclosure, the existing legal requirements and possible new disclosure rules. Comments were filed by July 24, 2007. DOL has indicated that it intends to propose new participant disclosure rules early in 2008 that will likely apply to all participant-directed individual account retirement plans.

#### ***PRINCIPLES FOR REFORM***

We support regulatory reforms that reflect the following principles:

- **Sponsors and Participants' Information Needs Are Markedly Different.** Any new disclosure regime must recognize that plan sponsors (employers) and plan participants (employees) have markedly different disclosure needs.
- **Overloading Participants with Unduly Detailed Information Can Be Counterproductive.** Overly detailed and voluminous information may impair rather than enhance a participant's decision-making.
- **New Disclosure Requirements Will Carry Costs for Participants and So Must Be Fully Justified.** Participants will likely bear the costs of any new disclosure requirements so such new requirements must be justified in terms of providing a material benefit to plan participants' participation and investment decisions.
- **Information About Fees Must Be Provided Along with Other Information Participants Need to Make Sound Investment Decisions.** Participants need to know about fees and other costs associated with investing in the plan, but not in isolation. Fee information should appear in context with other key facts that participants should consider in making sound investment decisions. These facts include each plan investment option's historical performance, relative risks, investment objectives, and the identity of its adviser or manager.
- **Disclosure Should Facilitate Comparison But Sponsors Need Flexibility Regarding Format.** Disclosure should facilitate comparison among investment options, although employers should retain flexibility as to the appropriate format for workers.
- **Participants Should Receive Information at Enrollment and Have Ongoing Access Annually.** Participants should receive fee and other key investment option information at enrollment and be notified annually where they can find or how they can request updated information.

**WRITTEN STATEMENT  
FOR THE RECORD**

**TO THE  
UNITED STATES SENATE  
SPECIAL COMMITTEE ON AGING**

**IN THE HEARING ON**

**HIDDEN 401(K) FEES:  
HOW DISCLOSURE CAN INCREASE RETIREMENT SECURITY**

**WEDNESDAY, OCTOBER 24, 2007**

**SUBMITTED  
ON BEHALF OF**

**THE ERISA INDUSTRY COMMITTEE  
SOCIETY FOR HUMAN RESOURCE MANAGEMENT  
NATIONAL ASSOCIATION OF MANUFACTURERS  
UNITED STATES CHAMBER OF COMMERCE  
AND  
PROFIT SHARING/401K COUNCIL OF AMERICA**

Chairman Kohl, Ranking Member Smith, and Members of the Committee, thank you for the opportunity to submit our views on the issue of 401(k) plan fee disclosure.

The ERISA Industry Committee (ERIC) is a nonprofit association committed to the advancement of America's major employer's retirement, health, incentive, and compensation plans. ERIC's members' plans are the benchmarks against which industry, third-party providers, consultants, and policy makers measure the design and effectiveness of other plans. These plans affect millions of Americans and the American economy. ERIC has a strong interest in protecting its members' ability to provide the best employee benefit, incentive, and compensation plans in the most cost effective manner.

The Society for Human Resource Management (SHRM) is the world's largest association devoted to human resource management. The Society serves the needs of HR professionals and advances the interests of the HR profession. Founded in 1948, SHRM has more than 225,000 members in over 125 countries, and more than 575 affiliated chapters.

The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The vast majority of NAM members provide 401(k) plans for their employees and thus have a significant interest in this legislation.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance -- is represented. Also, the Chamber has substantial membership in all 50 states, as well as 105 American Chambers of Commerce abroad. Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Established in 1947, The Profit Sharing / 401k Council of America (PSCA) is a national, non-profit association of 1,200 companies and their 6 million plan participants. PSCA represents its members' interests to federal policymakers and offers practical, cost-effective assistance with profit sharing and 401(k) plan design, administration, investment, compliance and communication. PSCA's services are tailored to meet the needs of both large and small companies. Members range in size from Fortune 100 firms to small, entrepreneurial businesses.

Let us begin by stating that we all strongly support concise, effective, and efficient fee disclosure to participants. We support increased transparency between service providers and plan sponsors, and between plan sponsors and participants. However, we all share strong concerns that legislative action could sharply increase compliance costs and litigation threats by adding complexity and new requirements well beyond what is

necessary to enhance the ability of plan participants to make good investment choices or the ability of plan sponsors to select the best service provider. Furthermore, we strongly urge that the Department of Labor (DOL) be allowed to complete its three current projects addressing fee disclosure before Congress assesses whether legislation is needed.

### **The Current System**

Numerous aspects of ERISA already safeguard participants' interests and 401(k) assets. Plan assets must be held in a trust that is separate from the employer's assets. The fiduciary of the trust (normally the employer or committee within the employer) must operate the trust for the *exclusive* purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. In other words, the fiduciary has a duty under ERISA to ensure that any expenses of operating the plan, to the extent they are paid with plan assets, are reasonable.

To comply with ERISA, plan administrators must ensure that the aggregate price of services in a bundled arrangement is reasonable at the time the plan contracts for the services and that the aggregate price for those services continues to be reasonable over time. For example, asset-based fees should be monitored as plan assets grow to ensure that fee levels continue to be reasonable for services with relatively fixed costs such as plan administration and per-participant recordkeeping. The plan administrator should be fully informed of all the services included in a bundled arrangement to make this assessment. Many plan administrators, however, may prefer reviewing costs in an aggregate manner and, as long as they are fully informed of the services being provided, they can compare and evaluate whether the overall fees are reasonable without being required to analyze each fee on an itemized basis.

It is important that as it considers new legislation, Congress fully understand the realities of fees in 401(k) plans. The vast majority of participants in ERISA plans have access to capital markets at *lower cost* through their plans than the participants could obtain in the retail markets because of economies of scale and the fiduciary's role in selecting investments and monitoring fees. The level of fees paid among all ERISA plan participants will vary considerably, however, based on variables that include plan size (in dollars and/or number of participants), participant account balances, asset mix, and the types of investments and the level of services being provided. Larger, older plans typically experience the lowest cost.

A study by CEM Benchmarking Inc. of 88 US defined contribution plans with total assets of \$512 billion (ranging from \$4 million to over \$10 billion per plan) and 8.3 million participants (ranging from fewer than 1,000 to over 100,000 per plan) found that total costs ranged from 6 to 154 basis points (bps) or 0.06 to 1.54 percent of plan assets in 2005. Total costs varied with overall plan size. Plans with assets in excess of \$10 billion averaged 28 bps while plans between \$0.5 billion and \$2.0 billion averaged 52 bps. In a separate analysis conducted for PSCA, CEM reported that, in 2005, its private sector corporate plans had total average costs of 33.4 bps and median costs of 29.8 bps.

Other surveys have found similar costs. HR Investment Consultants is a consulting firm providing a wide range of services to employers offering participant-directed retirement plans. It publishes the 401(k) Averages Book that contains plan fee benchmarking data. The 2007 edition of the book reveals that average total plan costs ranged from 159 bps for plans with 25 participants to 107 bps for plans with 5,000 participants. The Committee on the Investment of Employee Benefit Assets (CEIBA), whose more than 115 members manage \$1.4 trillion in defined benefit and defined contribution plan assets on behalf of 16 million (defined benefit and defined contribution) plan participants and beneficiaries, found in a 2005 survey of members that plan costs paid by defined contribution plan participants averaged 22 bps.

It is important that before Congress consider any legislation in an effort to enhance disclosure of these fees, that they fully understand the great deal many employees are already enjoying in their 401(k) plans.

### **Current Regulatory Action on Fees**

Fee disclosure and transparency present complex issues. Amending ERISA through legislation to prescribe specific fee disclosure will lock in disclosure standards built around today's practices and could discourage product and service innovation. The DOL has announced a series of regulatory initiatives that will make significant improvements to fee disclosure and transparency. **We support the DOL's efforts and have been active participants in them. While legislative oversight of DOL's disclosure efforts is appropriate, we believe that this is the best approach to enhance fee transparency in a measured and balanced manner and we urge Congress to delay taking legislative action until the DOL has completed its work.**

Among DOL's fee disclosure efforts are revised annual reporting requirements for plan sponsors. We expect DOL to release finalized modifications to the Form 5500 and the accompanying Schedule C, on which sponsors report compensation paid to plan service providers, within the next few weeks. The modifications will expand the number of service providers that must be listed and impose new requirements to report service provider revenue-sharing. The final regulations implementing the new Form 5500 are expected to first be applicable to the 2009 plan year.

DOL also intends later this year to issue a revised regulation under ERISA Section 408(b)(2), which is a statutory rule dictating that a plan may pay no more than reasonable compensation to plan service providers. The expected proposal is designed to ensure that plan fiduciaries have access to information about all forms and sources of compensation that service providers receive (including revenue-sharing). Both sponsors and providers will be subject to new legal requirements under these proposed rules, including an anticipated requirement that all third party compensation be disclosed in contracts or other service provider agreements with the plan sponsor.

The DOL's remaining initiative focuses on revamping participant-level disclosure of defined contribution plan fees. DOL issued a Request for Information ("RFI") in April 2007 seeking comment on the current state of fee disclosure, the existing legal requirements, and possible new disclosure rules. Several of us filed individual comments and we all issued a joint response with seven other trade associations. DOL has indicated that it intends to propose new participant disclosure rules early in 2008 that will likely apply to all participant-directed individual account retirement plans.

### **Principles of Reform**

As I said earlier, we do not oppose effective and efficient disclosure efforts. Working together with seven other trade associations, we developed a comprehensive set of principles that should be embodied in any efforts to enhance participant fee disclosure.

- **Sponsors and Participants' Information Needs Are Markedly Different.** Any new disclosure regime must recognize that plan sponsors (employers) and plan participants (employees) have markedly different disclosure needs.
- **Overloading Participants with Unduly Detailed Information Can Be Counterproductive.** Overly detailed and voluminous information may impair rather than enhance a participant's decision-making.
- **New Disclosure Requirements Will Carry Costs for Participants and So Must Be Fully Justified.** Participants will likely bear the costs of any new disclosure requirements so such new requirements must be justified in terms of providing a material benefit to plan participants' participation and investment decisions.
- **New Disclosure Requirements Should Not Require the Disclosure of Component Costs That Are Costly to Determine, Largely Arbitrary, and Provide Little Meaningful Information.** We believe that the requirement to "unbundle" bundled services and provide individual costs in many detailed categories is not particularly helpful and would lead to information that is not meaningful. It also raises significant concerns as to how a service provider would disclose component costs for services that are not offered outside a bundled contract. Any such unbundling would be subject to a great deal of arbitrariness. These costs will ultimately be passed on to plan participants through higher administrative fees.
- **Information About Fees Must Be Provided Along with Other Information Participants Need to Make Sound Investment Decisions.** Participants need to know about fees and other costs associated with investing in the plan, but not in isolation. Fee information should appear in context with other key facts that participants should consider in making sound investment decisions. These facts include each plan investment option's historical performance, relative risks, investment objectives, and the identity of its adviser or manager.

- **Disclosure Should Facilitate Comparison But Sponsors Need Flexibility Regarding Format.** Disclosure should facilitate comparison among investment options, although employers should retain flexibility as to the appropriate format for workers.
- **Participants Should Receive Information at Enrollment and Have Ongoing Access Annually.** Participants should receive fee and other key investment option information at enrollment and be notified annually where they can find or how they can request updated information.

We strongly urge that the requirements of any new legislation be measured against these background principles.

### **Conclusion**

We support effective fee disclosure. However, we strongly believe that the additional flexibility inherent in the regulatory system make DOL a more appropriate place for new disclosure requirements. DOL already has numerous initiatives underway to enhance disclosure between plan sponsors and participants and between plan sponsors and service providers. Any new legislative requirements would likely only slow those efforts resulting in delayed reforms.

Plan sponsors and service providers alike are committed to creating new investment options and administrative techniques to improve retirement security. Automatic enrollment, automatic contribution step-ups, target-date and lifecycle funds, managed accounts are just some of the numerous innovations that have benefited 401(k) participants—indeed some of them may not even have been participants if not for such products—and enhanced their retirement security. Statutory requirements for fee disclosure would freeze disclosure in the present, making enhancements and innovations more difficult in the future.

If the Committee proceeds with legislation, the Committee should ensure that it comports with the principles we have outlined in our testimony. Any other result could jeopardize the future of the defined contribution system at a time when it is increasingly critical for American workers.

We appreciate the opportunity to present our views on this very important matter.



## STATEMENT OF THE INVESTMENT COMPANY INSTITUTE

Hearing on "Hidden 401(k) Fees: How Disclosure Can Increase Retirement Security"  
 Special Committee on Aging  
 U.S. Senate  
 October 24, 2007

The Investment Company Institute<sup>1</sup> welcomes the interest of Chairman Kohl and the Senate Special Committee on Aging in enhancing disclosure in 401(k) plans and appreciates the opportunity to provide its views in connection with this hearing. The Institute has long supported effective disclosure to participants in individual account plans and the employers who sponsor those plans.<sup>2</sup> Mutual funds currently provide the most complete disclosure of any investment product available in 401(k) plans and the Institute has extensively studied what information is useful to and used by investors. We value the opportunity to offer constructive input as the Committee explores these issues. The Institute has joined the testimony presented by Robert Chambers for the American Benefits Council, the American Council of Life Insurers and the Institute. We are submitting this written statement by the Institute to highlight the Institute's long support for effective disclosure to 401(k) participants and employers.

The defined contribution system of 401(k) and similar plans has been a huge success. As of 2006, Americans had saved \$4.1 trillion in private defined contribution plans, and another \$4.2 trillion in IRAs. (Estimates suggest about half of all IRA assets originate from 401(k) and other employer plans.) Around half of all of the assets in defined contribution plans and IRAs are invested in mutual funds.<sup>3</sup>

Collaborative research between the Employee Benefit Research Institute (EBRI) and the Institute demonstrates that participants generally make sensible choices in allocating their investments<sup>4</sup> and that a full career with 401(k) plans produces adequate replacement rates at retirement.<sup>5</sup> Institute research also suggests that plan participants and plan sponsors are cost conscious when selecting mutual funds for their 401(k) plans. On an asset-weighted basis (that is, taking into account where 401(k) participants concentrate their assets), the average asset-weighted expense ratio for 401(k) stock mutual fund investors was 0.74%, half of the simple average stock mutual fund expense ratio in 2006 (1.50%).<sup>6</sup>

The biggest challenge in ensuring adequate retirement security for all Americans lies in encouraging workers to contribute and encouraging employers to offer a workplace plan. Disclosure reform should seek to improve the 401(k) system without imposing burdens, costs and liabilities that deter employers from offering plans. For these reasons, we urge the Committee to proceed carefully as it examines the 401(k) disclosure regime.



*The Investment Company Institute (ICI) is the national association of U.S. investment companies, which manage about half of 401(k) and IRA assets. ICI advocates policies to make retirement savings more effective and secure.*

Initiatives to strengthen the 401(k) disclosure regime should focus on the decisions that plan sponsors and participants must make and the information they need to make those decisions. The purposes behind fee disclosure to plan sponsors and participants differ. Participants have only two decisions to make: whether to contribute to the plan (and at what level) and how to allocate their account among the investment options the plan sponsor has selected. Disclosure should help participants make those decisions. Voluminous and detailed information about plan fees could overwhelm the average participant and could result in some employees deciding not to participate in the plan or focusing on fees disproportionately to other important information, such as investment objective, historical performance, and risks. On the other hand, plan sponsors, as fiduciaries, must consider additional factors in hiring and supervising plan service providers and selecting plan investment options. Information to plan sponsors should be designed to meet their needs effectively.

### **Principles for Reform**

- **Disclosure to plan sponsors should provide information that allows them to fulfill their fiduciary responsibilities.**

ERISA requires that plan fiduciaries act prudently and solely in the interest of plans and participants. Plan assets can only be used for the exclusive purpose of providing benefits and defraying reasonable expenses of administering plans. ERISA's prohibited transaction rules require that a contract with a service provider be for necessary services and provide only reasonable compensation. The Institute has consistently supported efforts to ensure that plan sponsors have the information they need as fiduciaries to select and monitor service providers and review the reasonableness of plan fees.<sup>7</sup> The Institute's views on disclosure to plan sponsors are set out in greater detail in the attached testimony we recently presented to the ERISA Advisory Council.

Plan sponsors should obtain information from service providers on the services that will be delivered, the fees that will be charged, and whether and to what extent the service provider receives compensation from other parties in connection with providing services to the plan. These payments from other parties, commonly called "revenue sharing," often are used in bundled and unbundled service arrangements to defray the expenses of plan administration.

We also recommend that a service provider that offers a number of services in a package be required to identify each of the services and total cost but not to break out separately the fee for each of the components of the package. If the service provider does not offer the services separately, requiring the provider to assign a price to the component services will produce artificial prices that are not meaningful. In today's competitive 401(k) market, bundled and unbundled providers compete effectively for plan business. This healthy competition has helped spur innovation in 401(k) products and services, such as new education and advice programs and target date funds. Forcing a 401(k) provider to quote separate prices for component services would constitute an inappropriate decision by policymakers to favor one

business model over another. So long as plan fiduciaries can compare the total cost of recordkeeping and investments of a bundled provider with the total costs of recordkeeping and investments of an unbundled provider, they have the relevant information to discharge their fiduciary obligations.

The Institute supports disclosure of revenue sharing by requiring that a service provider disclose to plan sponsors information about compensation it receives from other parties in connection with providing services to the plan. This information will allow the plan sponsor to understand the total compensation a service provider receives under the arrangement. It also will bring to light any potential conflicts of interest associated with revenue sharing payments, for example, where a plan consultant receives compensation from a plan recordkeeper.

Allocations among affiliated service providers are not revenue sharing. When services are provided by affiliates of the service provider, a plan sponsor should understand all the services that will be provided and the aggregate compensation for those services. The service provider should not be required to disclose how payments are allocated within the organization. These allocations are not market transactions and any pricing of these transactions will be artificial, and, thus, of little value. Disclosure of allocations within a firm will not inform the plan sponsor of additional compensation retained by the firm and will not inform the plan sponsor of a potential conflict that is not already apparent given the affiliation of the entities.

- **Disclosure to plan participants should be simple and focused on key information.**

Participants should receive the following key pieces of information for each investment product offered under the plan:

- Types of securities held and investment objective of the product
- Principal risks associated with investing in the product
- Annual fees and expenses expressed in a ratio or fee table
- Historical performance
- Investment adviser that manages the product's investments

Participants also need information about the plan fees that they pay, to the extent the fees are not included in the disclosed fees of the investment products. Finally, participants should be informed of any transaction fees imposed at the time of purchase (brokerage or insurance commissions, sales charges or front loads) or at the time of sale or redemption (redemption fees, deferred sales loads, surrender fees, market value adjustment charges).

This list is informed by research on what information investors actually consider before purchasing mutual fund shares.<sup>8</sup> The research also found that investors find a summary of information more helpful than a detailed document. This basic information should be

provided on all investment options available under the plan, regardless of type.<sup>9</sup> The need for cost-effective, simple disclosure focusing on the key information participants need to make informed choices enjoys broad support, as reflected in the attached joint recommendation by 12 trade associations to the Department of Labor.<sup>10</sup>

Fees and expenses are only one piece of necessary information. While the fees associated with a plan's investment options are an important factor participants should consider in making investment decisions, no participant should decide whether to contribute to a plan or allocate his or her account based solely on fees. In many plans the lowest fee option is a money market fund or other low-risk investment because these funds are the least costly to manage. It is not appropriate for most participants to invest solely in these relatively lower return options.<sup>11</sup>

ERISA disclosure rules should encourage and facilitate electronic delivery of investment information to participants. Plans should be allowed to provide online disclosure for every investment option for those employees who have reasonable access to the Internet.

Streamlining disclosure to mutual fund investors to focus on key information is underway at the SEC.<sup>12</sup> The SEC expects to propose this fall a new summary mutual fund prospectus that will focus on the information investors need to know, in a form they will use. With half of defined contribution plan assets in mutual funds, any changes to the disclosure system for plan participants should be consistent with the summary prospectus that the SEC develops for mutual funds; otherwise, 401(k) investors will bear the costs of mutual funds operating under different disclosure regimes. Both the SEC and the Department of Labor have indicated that the new summary fund prospectus, the work of years of study by regulators and the investment management community, could serve as a model for disclosure of other products.

Although fees and expenses are typically disclosed on the basis that they are charged, some participants may find it useful to have asset-based fees translated into illustrative dollar amounts. The SEC concluded in 2004 that the most comparable and cost-effective way to give shareholders an understanding, in dollar terms, of the implications of asset-based fees on their account was to require a fee example in shareholder reports showing the fee paid on each \$1,000 invested.<sup>13</sup> More complex dollar disclosures simply impose unnecessary costs and would not facilitate comparability. In 401(k) plans these costs generally would be borne by participants. We recommend that any ERISA requirement to provide participants with disclosure about the impact of fees on their accounts use a similar hypothetical example.

- **Congress should not mandate a 401(k) plan's investment line-up.**

One proposal (H.R. 3185) would require a 401(k) plan to offer an index fund meeting certain requirements. The Institute is concerned with mandating in federal law that 401(k)

plans offer a particular type of investment option. Congress should not substitute its judgment for investment experts and mandate investment choices properly reserved to plan sponsors as fiduciaries. It also should not endorse one type of investment strategy (indexing) over another (active management). This represents a significant departure from the basic fiduciary structure of ERISA and the Institute is concerned about the precedent this would set.

\* \* \* \*

The mutual fund industry is committed to meaningful 401(k) disclosure, which is critical to ensuring secure retirements for the millions of Americans that use defined contribution plans. We thank the Committee for the opportunity to submit this statement and look forward to continued dialogue with the Committee and its staff.

#### ATTACHMENTS

- Institute Policy Statement on Retirement Plan Disclosure (January 30, 2007) (available at [http://www.ici.org/pdf/ppr\\_07\\_ret\\_disclosure\\_stmt.pdf](http://www.ici.org/pdf/ppr_07_ret_disclosure_stmt.pdf))
- Institute Statement to ERISA Advisory Council (September 20, 2007) (available at [http://www.ici.org/statements/tmny/07\\_dol\\_disclose\\_tmny.html](http://www.ici.org/statements/tmny/07_dol_disclose_tmny.html))
- Joint Trade Association Recommendations on Fee and Expense Disclosures to Participants in Individual Account Plans (July 24, 2007) (available at [http://www.ici.org/statements/cmltr/2007/07\\_dol\\_401k\\_joint\\_com.html](http://www.ici.org/statements/cmltr/2007/07_dol_401k_joint_com.html))
- Institute Comment Letter to Department of Labor on Fee Disclosure RFI (July 20, 2007) (available at [http://www.ici.org/statements/cmltr/2007/07\\_dol\\_fee\\_disclose\\_com.html](http://www.ici.org/statements/cmltr/2007/07_dol_fee_disclose_com.html))

<sup>1</sup> Institute members include 8,889 open-end investment companies (mutual funds), 675 closed-end investment companies, 471 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the Institute have total assets of approximately \$11.339 trillion (representing 98 percent of all assets of US mutual funds).

<sup>2</sup> Attached to the testimony is a Policy Statement on Retirement Plan Disclosure adopted by the Institute Board of Governors in January 2007 that reaffirms and chronicles the Institute's long record in support of better disclosure.

<sup>3</sup> Brady and Holden, *The U.S. Retirement Market, 2006*, ICI Fundamentals, vol. 16, no. 3 (July 2007), available at <http://www.ici.org/pdf/fm-v16n3.pdf>.

<sup>4</sup> For example, in 2006, participants in their 20s allocated 59.7% of their accounts to pooled equity investments and company stock, and only 18.4% to GICs and other fixed-income investments. Participants in their 60s allocated 35.6% to GICs and other fixed-income investments. See Holden, VanDerhei, Alonso, and Copeland, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, ICI Perspective, vol. 13, no. 1, and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, August 2007, available at <http://www.ici.org/pdf/ppr13-01.pdf>. The 2006 EBRI/ICI database contains 53,931 401(k) plans with \$1.228 trillion in assets and 20.0 million participants.

<sup>5</sup> See Holden and VanDerhei, *Can 401(k) Accumulations Generate Significant Income for Future Retirees?* and *The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement*, ICI Perspective and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, November 2002 and July 2005, respectively, available at <http://www.ici.org/pdf/per08-03.pdf> and <http://www.ici.org/pdf/per11-02.pdf>, respectively.

<sup>6</sup> Holden and Hadley, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, 2006, ICI Fundamentals, vol. 16, no. 4 (September 2007), available at <http://www.ici.org/pdf/fm-v16n4.pdf>.

<sup>7</sup> For example, see Statement of the Investment Company Institute on Disclosure to Plan Sponsors and Participants Before the ERISA Advisory Council Working Groups on Disclosure (September 21, 2004), available at [http://www.ici.org/statements/tmny/04\\_dol\\_krentzman\\_tmny.html](http://www.ici.org/statements/tmny/04_dol_krentzman_tmny.html).

<sup>8</sup> See Investment Company Institute, *Understanding Investor Preferences for Mutual Fund Information* (2006), available at [http://www.ici.org/pdf/rpt\\_06\\_inv\\_prefs\\_full.pdf](http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf).

<sup>9</sup> As described in more detail in the attached Institute comment letter to the Department of Labor, disclosure of this information is appropriate for mutual funds, insurance separate accounts, bank collective trusts, and separately managed accounts. The same key pieces of information are relevant and should be disclosed for fixed-return products, where a bank or insurance company promises to pay a stated rate of return. In describing fees and expenses of these products, for example, the disclosure should explain that the cost of the product is built into the stated rate of return because the insurance company or bank covers its expenses and profit margin by any returns it generates on the participant's investment in excess of the fixed rate of return. In describing principal risks of these products, the summary should explain that the risks associated with the fixed rate of return include the risks of interest rate changes, the long-term risk of inflation, and the risks associated with the product provider's insolvency.

<sup>10</sup> Also attached is the Institute's comment letter to the Department of Labor regarding improvements to participant disclosure.

<sup>11</sup> In 2006, the asset-weighted average total mutual fund expense ratio for money market funds held in 401(k) plans was 0.43%, compared with 0.56% for bond mutual funds and 0.74% for stock mutual funds. See Holden and Hadley, *supra* note 6. In plans offering investment in employer stock, the employer stock option fund may be the lowest fee option because essentially no active investment management is involved, but it also would not be appropriate for participants to invest solely in one security. This point is made in the Department of Labor's publication for participants, *Taking the Mystery Out of Retirement Planning*, page 11, available at <http://www.dol.gov/ebsa/publications/NRTOC.html>.

<sup>12</sup> See Statement of the Securities and Exchange Commission Before the House Financial Services Committee (June 26, 2007), available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/sec\\_testimony\\_6-26-07.pdf](http://www.house.gov/apps/list/hearing/financialsvcs_dem/sec_testimony_6-26-07.pdf). The SEC's efforts are consistent with efforts to streamline mutual fund disclosure globally; both Canada and the European Union have proposed to amend their relevant disclosure documents to focus on key information. See Joint Forum of Financial Market Regulators, *Point of Sale Disclosure for Mutual Funds and Segregated Funds* (Proposed Framework 81-406, June 2007) (Canada); Committee of European Securities Regulators, *Consultation Paper on Content and Form of Key Investor Information Disclosures for UCITS* (CESR/07-669, October 2007) (European Union).

<sup>13</sup> See Securities and Exchange Commission, *Final Rule, Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies*, 69 Fed. Reg. 11244 (March 9, 2004).

## ICI POLICY STATEMENT

## Retirement Plan Disclosure

Adopted by ICI's Board of Governors, January 30, 2007

In 2005, there were 47 million active participants in 401(k) plans, with their retirement savings invested not only in mutual funds but also a wide range of other investment products. As 401(k) plans assume increasing importance for future retirees, plan sponsors must be able to make the right choices in setting up their plans and participants must have the information necessary to make informed investment decisions. To that end, the Institute urges that the Department of Labor clarify the requirements for disclosure of the fees and expenses associated with 401(k) plans to assist plan sponsors in making meaningful comparisons of products and service providers. Similarly, we support action by the Department of Labor to require straightforward descriptions of all the investment options available to participants in self-directed plans. To achieve these important goals:

- » **The Department of Labor should require clear disclosure to employers that highlights the most pertinent information, including total plan costs.**

We believe required disclosure to employers should focus on the total fees paid by the plan to a service provider (in the form of a percentage or ratio) and how expenses are allocated between the sponsor and participants. Required disclosure also should address the various categories of expenses associated with a plan, including arrangements where a service provider receives some share of its revenue from a third party. Under ERISA, the obligation to provide this information should rest with those parties having a direct relationship with the employer.



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In the late 1990s, the Institute, in cooperation with other private-sector organizations, created a Model 401(k) Plan Fee Disclosure Form, which is posted on the Department of Labor website. More recently, the Institute also helped develop a list of service- and fee-related items that plan sponsors should discuss with potential providers. These tools serve to identify what services will be provided for the fees charged, show all forms of expenses, and help employers make meaningful comparisons among the products and services offered to the plan. The tools also can be useful to the Department in crafting regulations and other guidance.

- » **The Department of Labor should require that participants in all self-directed plans receive simple, straightforward explanations about each of the investment options available to them, including information on fees and expenses.**

In making investment elections under a plan, individuals should receive information on:

- » investment objectives;
- » principal risks,
- » annual fees (expressed in a ratio or fee table),
- » historical performance, and
- » the investment adviser that manages the product's investments.

The Department should expand the current disclosure requirements to require plan administrators to provide participants with a concise summary of these five key pieces of information for *each* investment option. One effective way to deliver this information is through email and other forms of electronic communication. Additional information, such as how fees and expenses are allocated among service providers, should be made available to participants (for example, posted on the Internet).

Such disclosure requirements would fill gaps in the information currently required to be provided to participants. The existing disclosure regime does not cover all plans in which participants make investment decisions for their accounts. For plans that are covered, participants must receive full information about mutual funds, in the form of the fund prospectus. For other products, important information – such as operating expenses and historical performance – is available only on request. We support revising current rules to require a summary document for *all* self-directed plans that provides, for *each* investment product, the type of information that investors value and use. This information will empower participants in self-directed plans to manage their accounts effectively.

***The mutual fund industry is committed to meaningful disclosure.*** Over the past 30 years, the Institute has supported efforts to improve the quality of information provided to plans and participants and the way in which that information is presented. Meaningful disclosure is critical to ensuring secure retirements for millions of Americans.



## APPENDIX

## ICI's Record: 30 Years of Advocating Better Disclosure

The Institute has long acted both in conjunction with other organizations and on its own to enhance the ability of employers to make appropriate choices for their plans. The Institute also has consistently called for effective disclosure to plan participants about investment options. This appendix describes the Institute's efforts over time to improve disclosure for both plan sponsors and participants.

*Disclosure to Participants*

For more than 30 years, the Institute has provided specific recommendations to the Department of Labor on the disclosure participants in self-directed plans should receive about investment options. Through letters and testimony before the Department and the ERISA Advisory Council, we recommended regulatory measures to ensure that participants and beneficiaries receive adequate information on which to base their investment decisions.

- » In a 1976 letter to the Department, the Institute advocated that when an individual becomes a participant, he or she should receive complete, up-to-date information about plan investment options, and, thereafter, regular and current information as to his or her investments.
- » In 1987, the Institute recommended that under then-proposed 404(c) regulations, participants should receive the kind of information included in a mutual fund prospectus or Statement of Additional Information for all investment options—not just investment options subject to federal securities laws. We repeated this suggestion in 2001 to the Department and in testimony in 2004 and 2006 before the ERISA Advisory Council.
- » In 1992, the Institute recommended that where a 404(c) plan has a limited number of investment alternatives, plan fiduciaries should be required to provide sufficient investment information about each option up front. We urged the Department to specify the investment information that would be deemed sufficient, including information on fees and expenses and investment objectives.
- » In testimony before the Department in 1997, the Institute asked the Department to address gaps in the disclosure regime, especially disclosure of administrative fees charged to participant accounts and information on annual operating expenses, which, for non-mutual fund investment vehicles, are required to be provided only upon request.
- » In 1999, the Institute urged the Department to expand the scope of its proposed rules on electronic delivery to cover a broader range of disclosures and recipients.
- » In testimony before the ERISA Advisory Council in 2004 and 2006, the Institute called for participants to receive clear and concise summaries of each investment option, including the product's investment objective, principal risks, fee/expense ratio (in the form of a fee table), and information about the investment adviser. In 2006, we added historical performance to the list. In the 2006 testimony, we also urged that this disclosure regime should apply to all self-directed plans—not just 404(c) plans—and that the Department update and expand its electronic disclosure rule in light of the increasing role of the Internet.

### *Disclosure to Plan Sponsors*

The Institute likewise has consistently advocated clear rules for disclosure to plan sponsors and has developed various tools for use by sponsors and service providers.

- » In 1999, the Institute published a Uniform 401(k) Plan Fee Disclosure Form, developed jointly with the American Bankers Association (ABA) and American Council of Life Insurance (ACLI). The form, which the Department posted on its website, is designed to help employers identify and monitor 401(k) plan fees and expenses and compare the fees and services of different providers.
- » In testimony before the ERISA Advisory Council in 2004, the Institute called for clear, meaningful, and effective disclosure to plan sponsors. We recommended that plan sponsors be required to obtain complete information about investment options before adding them to the plan menu and obtain information concerning arrangements where a service provider receives some share of its revenue from a third party. The Institute offered to organize a task force to assist the Department in developing a disclosure regime for these compensation arrangements.
- » In 2005, the Institute published a Model Disclosure Schedule for Plan Sponsors that might be used to disclose information on receipt by service providers of revenue from unaffiliated parties in connection with services to a plan. The Institute began discussions with other trade associations on developing an appropriate disclosure regime.
- » In 2006, the Institute published a 401(k) plan fee and expense reference tool, developed jointly with the ACLI, ABA, Securities Industry Association, and American Benefits Council. The tool is a list of fee and expense data elements that plan sponsors and service providers may want to discuss when entering into service arrangements. We have asked the Department to post the tool on its website.



1401 H Street, NW  
Washington, DC 20005  
202/326-5800  
[www.ici.org](http://www.ici.org)

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## Statement of the Investment Company Institute

## ERISA Advisory Council

## Working Group on Fiduciary Responsibilities and Revenue Sharing Practices

Mary Podesta

Senior Counsel – Pension Regulation

September 20, 2007

The Investment Company Institute<sup>1</sup> is pleased to provide its views to the ERISA Advisory Council as it considers fiduciary responsibilities and revenue sharing practices. This is the third time in four years that we have testified to the Council on improving the ERISA regulatory regime in the interests of plan participants.

November of last year was the 25th anniversary of the birth of the 401(k) plan.<sup>2</sup> The Institute marked the occasion with a research retrospective that demonstrates that the 401(k) plan is a success story for Americans' retirement security.<sup>3</sup> As of year-end 2006, 401(k) plans held \$2.7 trillion in assets, an amount greater than that held by private defined benefit plans.<sup>4</sup> And this does not count assets that have been rolled over into IRAs. Estimates suggest about half of the \$4.2 trillion in IRAs in 2006 came from 401(k) and other employer plans. The number of 401(k) plans grew from fewer than 30,000 in 1985 to around 450,000 in 2006.<sup>5</sup>

Our research also shows that the assets of 401(k) plans are being effectively deployed to accumulate retirement wealth. Collaborative research by the ICI and the Employee Benefit Research Institute (EBRI) demonstrates that participants generally make sensible choices in allocating their investments<sup>6</sup> and that a full career with a 401(k) plan can produce adequate replacement rates at retirement.<sup>7</sup>

Plan fiduciaries play an essential role in assuring that workers can rely with confidence on 401(k) plans for retirement saving. Although 401(k) participants make their own investment decisions in most plans today, fiduciaries are charged with selecting an appropriate investment menu and entering into reasonable arrangements for the provision of administrative services to the plan. Often, plans contract to receive access to plan investment options and administrative services in a full service, or "bundled," arrangement in which a service provider offers the entire range of administrative services.

ERISA imposes clear responsibilities on fiduciaries in entering into any service arrangements. Under ERISA section 404(a), the fiduciary must act prudently and for the exclusive purpose of providing benefits and defraying the "reasonable" expenses of administering the plan. Under section 408(b)(2), fiduciaries must ensure that a service



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contract is a reasonable arrangement for necessary services and that "no more than reasonable compensation is paid therefor." If a service arrangement does not meet these standards, section 4975(d)(2) of the Internal Revenue Code imposes an excise tax against the service provider.

As we testified in 2004,<sup>8</sup> effective disclosure by service providers to plan sponsors is essential to enabling plan fiduciaries to enter into and maintain reasonable 401(k) service arrangements. The purpose of disclosure should be to allow plan fiduciaries to compare service options and monitor arrangements over time. The Institute has called upon the Department of Labor to require plan fiduciaries to obtain information from service providers on the services that will be delivered, the charges the plan will incur, and the extent to which service providers receive compensation from others in connection with providing services to the plan. To assist plan fiduciaries in entering into service arrangements, the Institute and others created a disclosure tool, discussed in more detail below.

The Institute's testimony today focuses on why plans may choose to obtain both investment and administrative services through a single service provider and how to meet a plan sponsor's need for information in entering into and monitoring these service arrangements.

#### 401(k) Service Arrangements

##### *Use of bundled arrangements and asset-based fees*

While a wide variety of practices exist, many plans contract with a recordkeeper to receive both administrative services and access to an array of investment products from which plan fiduciaries construct the menu of investments offered. The recordkeeper is compensated for its services to the plan, in whole or in part, by asset-based fees (such as sub-transfer agency or distribution fees) paid in connection with the plan's investment choices. These payments to recordkeepers from investment providers commonly are called "revenue sharing." Using a single full service provider eliminates the cost to a plan sponsor of dealing with and monitoring multiple providers, and provides a single responsible party for all aspects of the arrangement. A recent survey by Deloitte Consulting and others found that 75% of plan sponsors used a bundled arrangement.<sup>9</sup>

Using asset-based fees of plan investment options to defray the cost of recordkeeping and other plan administrative costs does not violate ERISA so long as a fiduciary does not use its discretion to cause itself to receive revenue sharing.<sup>10</sup> ERISA does not require flat charges for recordkeeping services. As the Department stated in testimony to the Working Group on July 11, "many of these arrangements may serve to reduce overall plan costs and provide plans with services and benefits not otherwise affordable."

Using asset-based fees to cover administrative services also effectively spreads the costs of acquiring necessary services over a shareholder or participant base. All mutual fund investors,

whether in a 401(k) plan, IRA, or taxable account, experience "mutualization." Some costs of administering a mutual fund shareholder's account are relatively fixed, such as the costs of printing prospectuses and sending shareholder statements. Because mutual funds charge asset-based fees, shareholders with larger investments subsidize smaller accounts. Similarly, wrap fees in brokerage accounts and M&E charges in insurance products mutualize certain costs in those products.

Under the Internal Revenue Code, a 401(k) plan and its services must be available to employees on a nondiscriminatory basis. Asset-based fees allow new participants and those with lower wages or smaller accounts to participate in plans without the cost of administration falling disproportionately, as a percentage of account balance, on them.

Asset-based fee arrangements also help pay for start-up or service provider transition costs. Service providers experience significant start-up expenses in servicing a newly created plan or beginning a client relationship with an existing plan that is moving from a previous provider. To avoid the plan incurring all those expenses in the first year, asset-based fees allow the provider to recoup its expenses over several years as assets grow. Absent these arrangements, employers would be less willing to establish new plans or switch service providers.

#### *Monitoring and reviewing services and fees over time*

Plan fiduciaries should monitor and review plan service arrangements from time to time to assure that they remain reasonable arrangements. In a bundled services arrangement where a plan recordkeeper receives asset-based compensation to defray the cost of recordkeeping, one aspect of the review will involve looking at the level of fees if the plan and participant accounts grow in size.

If the growth of plan assets supports a revision of the arrangement, the plan fiduciary and service provider have a number of options. One is to lower total plan costs by replacing existing plan investments with lower-cost options or share classes. Another is to provide the plan and participants with additional services that were not originally affordable. For example, as a new plan grows, it may become possible to provide participants with access to investment advice. A third option for plan fiduciaries might be to negotiate with the recordkeeper to share some of the recordkeeper's revenue with the plan.<sup>11</sup> Finally, the plan fiduciary can put the service contract out for bid to determine whether other service providers might offer comparable services at a lower cost. According to one recent study, plan sponsors, on average, evaluate their recordkeeper about every four years.<sup>12</sup>

#### *Mutual funds in 401(k) plans*

Of the \$2.7 trillion in 401(k) assets at year-end 2006, \$1.5 trillion, or about 55%, are invested in mutual funds. As a percentage of total 401(k) assets, mutual fund investment has

increased significantly. In 1994 only about 27% of 401(k) assets were invested in mutual funds.<sup>13</sup>

Institute research suggests that plan fiduciaries are cost conscious when selecting mutual funds for their 401(k) plans. Attached to this testimony is just-released research on the fees incurred by mutual fund investors in 401(k) plans. This research updates, with 2006 data, research we released last year, which married for the first time our extensive research on trends in mutual fund fees with our tracking of 401(k) plan holdings of mutual funds. Our research studies mutual fund fees in 401(k) plans because comparable information for other products offered in 401(k) plans is not readily available.<sup>14</sup>

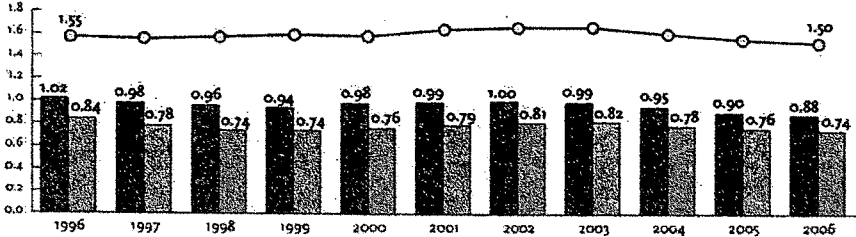
In the competitive mutual fund market, 401(k) savers tend to concentrate their assets in low-cost funds. In 2006, the average stock mutual fund had an expense ratio of 1.50%. This is the simple average that does not reflect investment concentration: 77% of stock mutual fund assets in 401(k) plans were invested in funds with a total expense ratio of less than 1.00%. On an asset-weighted basis, the average expense ratio incurred by all mutual fund investors in stock mutual funds was 0.88%. And the asset-weighted average expense ratio for 401(k) stock mutual fund investors was even lower: 0.74%. Similar results can be seen in each broad type of stock fund, as well as in bond funds. Overall, the asset-weighted average expense ratio across all mutual funds in 401(k) plans was 0.71% in 2006. These expense ratios include any revenue sharing that a fund pays to defray the cost of 401(k) plan administration.

#### 401(k) Mutual Fund Investors Tend to Pay Lower-Than-Average Expenses

Percent of assets, 1996–2006

- Industry Average Expense Ratio<sup>1</sup>
- ▒ 401(k) Average Expense Ratio<sup>2</sup>
- Industry Simple Average Expense Ratio

##### STOCK MUTUAL FUNDS



<sup>1</sup> The industry average expense ratio is measured as an asset-weighted average.

<sup>2</sup> The 401(k) average expense ratio is measured as a 401(k) asset-weighted average.

note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds.

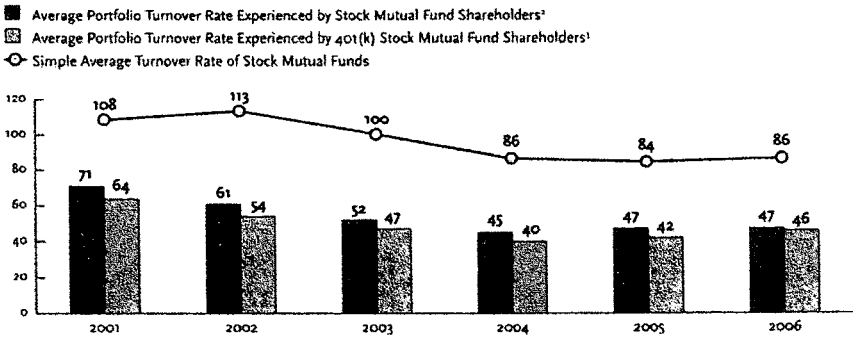
sources: Investment Company Institute; Lipper, Value Line Publishing, Inc.; CDA/Wiesenberger Investment Companies Service; © CRSP University of Chicago, used with permission. All rights reserved (312.263.6400/ www.cisp.com); Primary data source; and Strategic Insight Simfund

There are several factors that contribute to the relatively low average fund expense ratios incurred by 401(k) plan participants. Plan sponsors play a vital role in selecting and regularly evaluating the plan's investment line-up to ensure that each option's fees and expenses provide good value. Easy access to comparable and transparent mutual fund fee information helps employees in selecting investments for their accounts.<sup>15</sup>

Because the costs of trading a mutual fund's portfolio affect total shareholder return, but are not included in fund expense ratios, the Institute also examined portfolio turnover ratios of mutual funds used in 401(k) plans.<sup>16</sup> Our research found that 401(k) plan participants tend to own stock mutual funds with low turnover rates. The average turnover rate in stock mutual funds held in 401(k) plans was 46% in 2006, which is lower than the simple average turnover rate in stock mutual funds generally (86%) and about the same as the industrywide asset-weighted average rate of 47%.

### Average Portfolio Turnover Rate<sup>1</sup> of Stock Mutual Funds

Percent of assets, 2001–2006



<sup>1</sup> The turnover rate for each fund is calculated by dividing the lesser of purchases or sales of portfolio securities for the reporting period by the monthly average of the value of the portfolio securities owned by the fund during the reporting period.

<sup>2</sup> Average portfolio turnover rate experienced by stock mutual fund shareholders is measured as an asset-weighted average annual turnover rate based on the assets held in each fund (reported as a percentage of fund assets).

<sup>3</sup> Average portfolio turnover rate experienced by 401(k) stock mutual fund shareholders is measured as an asset-weighted average annual turnover rate based on 401(k) plan assets held in each fund (reported as a percentage of 401(k) fund assets).

Note: Figures exclude mutual funds available as investment choices in variable annuities. Stock mutual funds include hybrid funds.

Sources: Investment Company Institute and Strategic Insights Simfund.

### Meeting Plan Fiduciary Needs for Information

#### *Department of Labor section 408(b)(2) project*

The Institute believes that we can make certain that plan fiduciaries are equipped to enter into reasonable service arrangements by assuring that they have the information they need to make informed decisions. The Institute supports the Department's initiative to revise its section 408(b)(2) regulations to clarify the information that fiduciaries should obtain in order to enter into and monitor plan service arrangements. We urge the Department to move quickly on this project and to take a commonsense, straightforward approach.

The Department should require plan fiduciaries to obtain information from service providers to the plan on

- What services will be delivered;
- What will be charged for these services and how expenses will be allocated between the sponsor and participants;
- Whether and to what extent the service provider receives compensation from other parties in connection with providing services to the plan.

Disclosure should focus on the cost to the plan of acquiring services, not the cost to the service provider of delivering the service. ERISA does not require plan fiduciaries to assess service provider profitability, but rather to enter into contracts that provide for reasonable compensation.

A service provider that offers a number of services in a package should be required to identify each of the services but not to separately break out the fee for each of the components of the package. If a recordkeeper, for example, provides a comprehensive array of services, including maintaining participant-level accounts, providing custody, and making educational materials and other services available to participants, it should not be forced to assign prices to each component. If the plan sponsor understands the services that will be performed and the total cost of the service arrangement, it will be able to compare overall cost and quality of the bundled provider's offer with an unbundled arrangement available to the plan, and fulfill its responsibility to enter into reasonable service arrangements.

The Department should address revenue sharing disclosure by requiring that a service provider disclose to plan sponsors information about compensation it receives from other parties in connection with providing services to the plan. This information will allow the plan fiduciary to understand the total compensation a service provider receives under the arrangement. It also will bring to light any potential conflicts of interest associated with revenue sharing payments, for example, where a plan consultant receives compensation from a



plan recordkeeper. The service provider that receives revenue sharing payments should be the entity required to disclose these amounts.

When services are provided to a plan by affiliates of the service provider, a plan fiduciary should understand all the services provided by the service provider and its affiliates and the aggregate compensation paid for those services. The service provider should not be required to disclose how payments within its organization might be allocated among affiliates. In economic terms, transactions between affiliates are not market transactions, and therefore the pricing of these transactions is necessarily artificial and should be of no value to plan sponsors. The reason a firm would choose to organize as a fully integrated firm rather than contract with third parties is that the firm believes it is more efficient to do so. The goal of resource allocation within an integrated firm is to allocate resources in a manner that produces the final bundled product as efficiently as possible, not to ensure that costs can be accurately tracked and allocated to the production of any one product component. In this model, any allocation of revenue, costs and profits among affiliates or business lines has nothing to do with the services provided by the respective affiliates to the plan, but instead is designed for budgeting, accounting and other purposes.

#### *Disclosure tool*

To assist plan fiduciaries in discussing service arrangements with providers and to help inform the Department's consideration of new 408(b)(2) guidance, the Institute, together with the American Benefits Council, the American Council of Life Insurers, the American Bankers Association, and the Securities Industry and Financial Markets Association, developed a disclosure tool and submitted it to the Department in July 2006. Plan sponsors can use the tool to better understand plan services and fees and appreciate any potential conflicts of interest that might arise, and any additional compensation providers will receive, through revenue sharing. The tool was developed with significant input from the plan sponsor, service provider and consultant communities to reflect best practices used by sponsors, providers and consultants in today's marketplace.

The tool lists service- and fee-related data elements and is intended, essentially, to help plan fiduciaries satisfy their obligations under ERISA sections 404(a) and 408(b)(2) to understand what services will and will not be provided, and the fees for those services. It can be used regardless of the arrangement, whether a particular provider is offering only one service or a package of services. A service provider offering several services for a single fee would show the single fee and make clear what services are included. The tool also can be used when a plan sponsor works with a consultant in engaging providers and selecting investments and when it does not.<sup>17</sup>

The tool takes the approach to revenue sharing disclosure discussed above. It includes a section for plan fiduciaries and service providers to discuss the extent to which a service

provider receives compensation in connection with its services to the plan from other service providers or plan investment products. For payments received from unaffiliated parties, the tool recommends that plan sponsors and service providers discuss:

- Identification of the unaffiliated party
- Estimate or amount of the payment (including the estimation calculation methodology), and
- Information on the source and nature of the payment.

For payments from affiliated parties, service providers would identify the affiliate, state whether the payment received from the affiliate has any impact on the aggregate revenue received by the firm in connection with services to the plan, and provide non-proprietary information about the nature of the payment.

### Conclusion

There is no single "reasonable" fee and service arrangement for a 401(k) plan. A plan fiduciary must consider all the services and investment options being provided, the size and characteristics of the plan, and the services and fees available from other providers. Full-service arrangements that use asset-based fees can be an effective way to deliver the services that 401(k) plans need. The key is that fiduciaries have a process to collect information, compare and monitor providers, and consider any potential conflicts the arrangements might present. The Department should act to increase transparency by requiring service providers to describe the services offered, the charges to be paid, and payments from other parties in connection with providing services to the plan. We are pleased to testify to the Council about improving 401(k) disclosure and look forward to working with the Council and the Department to continue strengthening the 401(k) system.

### ATTACHMENTS

- *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006* (September 2007)
- Joint Submission to DOL by ICI, ABC, ACLI, ABA, and SIFMA on Data Elements Related to Defined Contribution Plan Fee Disclosure (July 31, 2006)

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<sup>1</sup> ICI members include 8,803 open-end investment companies (mutual funds), 671 closed-end investment companies, 457 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$11.140 trillion (representing 98% of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.

<sup>2</sup> On November 10, 1981, IRS issued proposed regulations under the new section 401(k) of the Internal Revenue Code added by Congress in 1978 that clarified the most important interpretative issues under the new law, including whether ordinary wages and salary could be deferred into the plan.

<sup>3</sup> Holden, Brady and Hadley, *401(k) Plans: A 25-Year Retrospective*, ICI Perspective, vol. 12, no. 2 (November 2006), available at <http://www.ici.org/stats/res/arc-res/per12-02.pdf>.

<sup>4</sup> Brady and Holden, *The U.S. Retirement Market, 2006*, ICI Fundamentals, vol. 16, no. 3 (July 2007), available at <http://www.ici.org/stats/res/1fm-y16n3.pdf>.

<sup>5</sup> U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin Historical Tables* (March 2007); Cerulli Associates, "Retirement Markets, 2006," *Cerulli Quantitative Update* (2006).

<sup>6</sup> For example, in 2006, participants in their 20s allocated 59.7% of their accounts to pooled equity investments and company stock, and only 18.4% to GICs and other fixed-income investments. Participants in their 60s allocated 35.6% to GICs and other fixed-income investments. See Holden and VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, ICI Perspective, vol. 13, no. 1, and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, August 2007, available at <http://www.ici.org/stats/res/per13-01.pdf>. The 2006 EBRI/ICI database contains 53,931 401(k) plans with \$1.228 trillion in assets and 20.0 million participants.

<sup>7</sup> See Holden and VanDerhei, *Can 401(k) Accumulations Generate Significant Income for Future Retirees? and The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement*, ICI Perspective and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, November 2002 and July 2005, respectively, available at <http://www.ici.org/pdf/per08-03.pdf> and <http://www.ici.org/pdf/per11-02.pdf>, respectively.

<sup>8</sup> See Statement of Investment Company Institute on Disclosure to Plan Sponsors and Participants Before the ERISA Advisory Council Working Group on Disclosure, September 21, 2004, available at [http://www.ici.org/statements/umny/04\\_dol\\_krenzman\\_umny.html](http://www.ici.org/statements/umny/04_dol_krenzman_umny.html).

<sup>9</sup> Deloitte Consulting, LLP, International Foundation of Employee Benefit Plans and the International Society of Certified Employee Benefit Specialists, *Annual 401(k) Benchmarking Survey 2005/2006 Edition*.

<sup>10</sup> See Advisory Opinion 97-16A (May 23, 1997) (Aetna) and Advisory Opinion 2003-09A (June 25, 2003) (ABM-AMRO).

<sup>11</sup> In its testimony on July 11, the Department made clear that an arrangement where a recordkeeper shares some of its revenue with the plan does not violate ERISA and plans have a number of options to address the allocation of revenue sharing proceeds.

<sup>12</sup> Deloitte Consulting, LLP, International Foundation of Employee Benefit Plans and the International Society of Certified Employee Benefit Specialists, *Annual 401(k) Benchmarking Survey 2005/2006 Edition*.

<sup>13</sup> Brady and Holden, *The U.S. Retirement Market, 2006*, *supra* note 4.

<sup>14</sup> We are not aware of any similar cost analysis for other products held in 401(k) plans such as insurance company separate accounts, collective trusts, or separately managed accounts.

<sup>15</sup> For other factors that contribute to the relatively low expense ratio incurred by 401(k) plan participants investing in mutual funds, see Holden and Hadley, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, 2006, ICI Fundamentals, vol. 16, no. 4 (September 2007).

<sup>16</sup> The SEC requires a mutual fund to report its turnover rate, which is broadly speaking a measure of how rapidly the fund is trading the securities in its portfolio relative to total fund assets. Funds also report information on brokerage commission costs in the fund's Statement of Additional Information. Although brokerage commissions are not included in the expense ratio, a mutual fund reports its net return, which reflects all fund trading costs.

<sup>17</sup> Using the tool is not the only way a plan fiduciary could meet its obligations under section 408(b)(2). We do not believe the Department should adopt a particular form in connection with the 408(b)(2) regulations that always must be used. A mandated form would not recognize the variety of service arrangements that might exist, would become outdated over time, and could stifle innovation in the marketplace.



July 24, 2007

FILED ELECTRONICALLY

U.S. Department of Labor  
Employee Benefits Security Administration  
Office of Regulations and Interpretations  
200 Constitution Avenue, NW, Room N-5669  
Washington, DC 20210  
Attention: Fee Disclosure RFI

Re: Fee and Expense Disclosures to Participants in Individual Account Plans

Dear Sir or Madam:

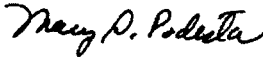
The undersigned twelve organizations representing both employer sponsors of defined contribution retirement plans as well as the financial institutions that provide services to such plans respectfully submit the attached joint recommendations in response to the Request for Information ("RFI") issued by the Department of Labor (the "Department") regarding fee and expense disclosures to participants in individual account plans, published at 72 Fed. Reg. 20,457 (April 25, 2007). We appreciate the opportunity to provide input on this important matter.

Several of the undersigned organizations worked together last year to develop and submit joint recommendations and a fee and expense reference tool with respect to the Department's ongoing project under ERISA Section 408(b)(2) related to fee disclosure between plan fiduciaries and service providers. With the same goal of achieving consensus on how to enhance fee disclosure, an even broader group of interested organizations has worked together over the past several months to develop joint recommendations regarding participant-level disclosure of defined contribution plan fee information. On this important issue, our organizations believe the Department has both the statutory authority and institutional expertise to improve disclosure of fee information to participants without new legislation. We hope the attached recommendations, which

have the support of this broad array of organizations active in the retirement policy arena, will be of significant use to the Department as it considers what changes to current disclosure requirements may be appropriate.

Our organizations would welcome the opportunity to meet with Department officials to discuss the attached recommendations and will plan to be in contact in this regard. In the meantime, please feel free to contact any of the individuals and organizations listed below.

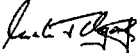
Sincerely,



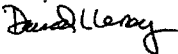
Mary Podesta  
Senior Counsel - Pension Regulation and  
Acting General Counsel  
Investment Company Institute



Ann Cammack  
Senior Vice President, Taxes  
and Retirement Security  
American Council of Life Insurers



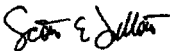
Mark Ugoretz  
President  
The ERISA Industry Committee



David Wray  
President  
Profit Sharing / 401(k) Council of America



Dorothy Coleman  
Vice President, Tax and Economic Policy  
National Association of Manufacturers



Scott Talbot  
Senior Vice President of Government  
Affairs  
The Financial Services Roundtable



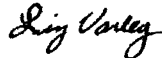
Jan Jacobson  
Retirement Policy Legal Counsel  
American Benefits Council



Judy Schub  
Managing Director  
Committee on Investment of Employee  
Benefit Assets



Lisa Bleier  
Senior Counsel  
American Bankers Association



Liz Varley  
Managing Director  
Securities Industry and  
Financial Markets Association



Randel K. Johnson  
Vice President, Labor, Immigration, &  
Employee Benefits  
U.S. Chamber of Commerce



Michael Aitken  
Director, Government Affairs  
Society for Human Resource Management

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American Bankers Association  
 American Benefits Council  
 American Council of Life Insurers  
 Committee on Investment of Employee Benefit Assets  
 ERISA Industry Committee  
 Financial Services Roundtable  
 Investment Company Institute  
 National Association of Manufacturers  
 Profit Sharing/401(k) Council of America  
 Securities Industry and Financial Markets Association  
 Society for Human Resource Management  
 U.S. Chamber of Commerce

*Joint Submission to the Department of Labor:  
 Recommendations for Participant-Level Disclosure of  
 Defined Contribution Plan Fee Information*

- Disclosure Regarding Fees is Important to Defined Contribution Plan Participants.** An increasing number of Americans rely on employer-sponsored defined contribution plans (such as 401(k)s) to help them accumulate the savings they will need for a secure retirement. Many defined contribution plan participants make their own investment elections from among the options offered by the plan and it is important that they have appropriate information to assist them in making these decisions. Disclosure about the fees associated with the plan and its investment options are an important component of this information. All defined contribution plans have costs. Participants often pay these costs under arrangements that differ from plan to plan. We believe it is beneficial for participants to have a general understanding of their plan's fee structure and the overall magnitude of the costs they bear as well as to receive fee information that is material in selecting specific investments for their accounts. Disclosure requirements should be evaluated based on whether information provided will be useful to typical plan participants in making investment selections. The benefits to participants should be real rather than hypothetical. More disclosure will not always be better. Under existing legal standards, plan fiduciaries (typically the employer plan sponsor) and service providers have worked hard to provide participants with meaningful, clear and concise information about key characteristics of plan investment options, including fees, and they continually seek to enhance these disclosures. Our organizations are eager to work with policymakers to improve existing legal standards regarding disclosure, where appropriate, to ensure that participants have information to make sound investment decisions. Any prospective enhancements to current law should foster simplicity, flexibility and efficiency in fee disclosure so that the result is a stronger defined contribution system for plan participants rather than one weakened by complex and costly disclosure that fails to serve participants' interests.
- Enhanced Disclosure Requirements Regarding Fees Should Extend to All Participant-Directed Retirement Plans.** New fee disclosure requirements should apply to all participant-directed individual account retirement plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) rather than only to ERISA 404(c) plans. In this regard, the Department of Labor (DOL) has the authority to promulgate disclosure

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standards for all participant-directed individual account retirement plans under ERISA.<sup>1</sup> The focus of policymakers should be on improving disclosure practices in all participant-directed plans, as this will serve participants' interests more than a detailed reworking of the ERISA 404(c) regulations.

- **Fee Disclosure to Participants Serves Different Needs Than Fee Disclosure to Plan Fiduciaries.** The purposes behind fee disclosure to plan fiduciaries and plan participants are fundamentally different. In selecting and monitoring service providers and in selecting a plan's menu of investment options, plan fiduciaries engage in acts subject to ERISA-imposed obligations, including to act prudently and in the best interest of participants, to pay no more than reasonable compensation and to avoid prohibited conflicts of interest. Such fiduciary determinations are aided by having detailed information about the services provided, fees charged and compensation earned by plan service providers (including through revenue sharing from third parties). Participants, on the other hand, do not select among service providers or determine the menu of plan investment options. They choose investments for their account from a menu of plan investment options selected by the plan fiduciary. The fees associated with the plan and its investment options are only one of a number of important criteria for making sound investment decisions. The voluminous and detailed information about plan fees and provider compensation (including revenue sharing) that is typically appropriate for plan fiduciaries to consider will not help participants select among plan investment options. Rather, providing this detail to plan participants could impair sound decision-making by overloading them with information, elevating fees above other investment selection criteria (which can produce poor investment decisions) and contributing to the decision paralysis that keeps some participants from joining plans. In light of the many other disclosures plans are required to provide to participants, an additional notice that is unduly detailed or technical will often be a source of aggravation to participants, reducing their interest in plan information generally. Policymakers should keep in mind the distinct purposes behind plan fiduciary and plan participant fee disclosure as they craft new participant disclosure rules.
- **Disclosure to Participants Should Include Expenses That Affect Participants' Choices.** Participants should be informed of the asset-based fees they will be charged for participating in the plan (typically expressed as a rate, in basis points), whether such fees are levied by particular investment options or charged regardless of the specific investment options selected by the participant. Fee disclosure to participants about investment options should also include any additional per-participant charges associated with the investment, such as charges for buying, selling or redeeming the investment (such as front- and back-end sales charges, redemption fees and market value adjustment charges). Plans also should inform participants about the existence of any plan administration or ongoing service charges that participants will pay on a per account (rather than an asset-based) basis. In some plans, asset-based charges on investments not only finance investment management but also defray other plan costs (such as plan administration). Where this is the case, participants should receive a general disclosure that the asset-based fees on investments

<sup>1</sup> DOL has authority under ERISA Section 505 to require that all participants who have the right to direct investment of their accounts have basic information about plan investment options. ERISA Section 505 grants DOL authority to issue such regulations as are necessary or appropriate under Title I of ERISA, which includes the statute's fiduciary responsibility requirements. In addition, ERISA Section 109 grants DOL authority to prescribe the content of various reports and documents, including materials furnished or made available to participants.

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defray other plan costs. More detail about the components of asset-based fees is not relevant to the total cost of investing, which is the information participants need. By disclosing the rate of asset-based fees together with information on any additional per account administrative charges, participants will be provided with a clear understanding of the costs of investing under the plan. Participants should also be informed that some transactions or services (e.g., plan loans or use of investment advice, managed account or brokerage window services) will result in additional charges to participant accounts, the specifics of which will be disclosed at the time the participant uses these services. Because most of these transactional charges will never apply to most participants, requiring detailed disclosure to all participants as to the specifics of such charges would make fee disclosure cumbersome and obscure the core information. Detailed information about costs for participant-initiated transactions and services should be made available upon participant request and provided at the time of the transaction. Plan fiduciaries should have flexibility to determine the precise form of the key fee disclosures discussed herein based on the facts and circumstances, but they will typically be expressed as a rate (in basis points) and/or as an illustrative dollar charge.

- **Fee Information Should Appear Alongside Other Key Information Participants Need to Make Investment Decisions.** Fees should be disclosed along with other information participants need to make informed investment decisions. Fee information should not be elevated so as to suggest that fees are the most important factor in selecting investments from among the plan's options. An undue focus on fees in new required disclosures might encourage participants to select the plan's lowest-cost investment option, which may not be the best choice for a participant. Instead, fees associated with a plan's investment option should be disclosed together with other key information: the option's investment objective and product characteristics, its historical performance and risks and the identity of the investment advisor or product provider. This information should be conveyed in clear and simple terms, and plan fiduciaries should have flexibility to determine the format in which the information is communicated to participants. Web-based disclosure of information about investment options will often be the most useful because it permits participants to browse multiple interrelated pieces of information and access more detailed information about a given investment option or topic of interest to them.
- **Polymakers Should Be Sensitive to Costs When Imposing New Disclosure Requirements.** While participant disclosure should provide sufficient information on fees and other key investment option characteristics for participants to make sound investment decisions, new disclosure requirements come with added costs. Such costs must be justified in terms of providing a material benefit to participants selecting among plan investments. The costs of some potential disclosure requirements would simply be exorbitant and unjustified. Any new disclosure requirements necessarily will impose expenses and burdens on both plan sponsors and plan service providers and will come on top of the multitude of new and costly disclosures required under the Pension Protection Act of 2006. The costs of new disclosure requirements are likely to be reflected in higher prices for plan administrative services, which are payable from plan assets. As a result, in many defined contribution plans the added costs of new disclosure requirements are likely to be borne in substantial part by plan participants. Plan fiduciaries and providers also will be concerned that expanded disclosure requirements could result in new and costly liabilities, a result that would further increase expenses in the system. New disclosure costs and potential



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liabilities could deter some small employers from sponsoring a qualified retirement plan for employees. Given these considerations, it is imperative that new participant disclosures be focused squarely on providing participants with information that will actually be useful in making investment decisions.

- **Use of Electronic Technologies to Provide Plan Investment and Fee Information Should Be Strongly Encouraged.** One important way to reduce costs and provide more useful information is to take full advantage of electronic mechanisms for delivering and providing access to information. New rules should move beyond existing regulations to permit, and indeed encourage, employers to use internet or intranet posting to deliver and provide access to fee and other information on plan investment options. (We recognize that certain participants without computer access will continue to need access to paper copies.) Notifying participants about the posting or availability of required disclosures on websites will typically be the most inexpensive method of delivery and should be promoted under new disclosure rules. As is common today, plan fiduciaries will work with service providers to provide required information on plan investment options to participants and should be able to connect participants directly to content on the websites of service providers (via click-through web links or otherwise) rather than having to maintain all information on plan investment options and fees on their own internet or intranet site.
- **Disclosure of Fees and Other Plan Investment Information Should Facilitate Comparisons.** While plan fiduciaries should retain flexibility to determine the specific format for communicating fee and other plan investment information to their particular participant population, they should strive to disclose the information in a form that facilitates comparison across the plan's investment options. At the same time, unique features of particular investment options also would have to be communicated. Web-based disclosure methods and tools are likely to be the most useful as they can visually convey the full range of plan investment options while allowing participants to access more detailed information about each option via click-through web links.
- **Participants Should Have Access to Fee and Other Investment Information at Enrollment and Annually Thereafter.** Participants should receive disclosure about plan fees (asset-based fees, transaction charges associated with investment options, any separate per account administrative fees and the potential for participant-initiated transaction and service charges) and the other key characteristics of investment options when they enroll in the plan and select plan investments for the first time. Some plans, particularly ones that have formulas for reducing plan fees as assets grow, will not know in advance the exact asset-based or per account fee levels that participants can expect in the year ahead. As a result, plan fiduciaries should be permitted to use fee levels from the most recently concluded plan year in the fee disclosures they make to participants at enrollment. In addition, on an annual basis, plan fiduciaries should inform participants where they can find or how they can request updated information on fees and other characteristics of plan investment options (by providing a click-through web link or directing them to an internet or intranet website, telephone number or plan official). Plan fiduciaries should have flexibility as to whether to make this annual disclosure -- regarding where participants can find or how they can request such information -- a stand-alone communication or a component of an existing disclosure document. Plan fiduciaries should ensure that the

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underlying general information on fees and other characteristics of plan investment options is updated annually to reflect any changes.

- **Plans Should Disclose to Participants Administrative and Transaction Dollar Charges Deducted from Participant Accounts.** Participants should receive disclosure regarding any administrative or transaction flat dollar charges that have been deducted from their accounts. Such charges would include per account flat dollar charges imposed on all participants for the costs of plan administration as well as any dollar charges that result from purchases or sales of particular investments or from participant-initiated transactions or services (such as plan loans). Plan fiduciaries should have flexibility as to the means and timing of such disclosures. For example, some fiduciaries may include this information in quarterly benefit statements while others may include it in a confirmation notice following a particular transaction.
- **Participants Have Access to Education Materials that Provide Context for Fee and Other Plan Investment Information.** Participants make the best use of information about their plan investment options (including information regarding fees) when this information builds on basic investment education. The Pension Protection Act of 2006 (PPA) requires that participants have access to investment education materials and a new requirement in this area is not needed. Under PPA, the quarterly benefit statements provided to participants who direct their retirement plan investments must include a notice directing participants to a Department of Labor (DOL) website on individual investing and diversification (<http://www.dol.gov/ebsa/investing.html>). This website includes the DOL's brochure, *A Look at 401(k) Plan Fees*. Plan sponsors may wish to direct participants to this resource at other times, including at enrollment when they provide participants with initial information on plan investment options and fees. Plan sponsors will also likely want to continue to draw on investment education materials that they and their service providers develop. Given the extensive work by the private sector in the investment education area and the new prominence of the DOL's individual investing website as a result of the PPA requirement, we recommend that the DOL establish a formal and periodic process to seek private-sector input regarding the contents of its site.



1401 H Street, NW, Washington, DC 20005-2148, USA  
202/326-5800 www.ici.org

July 20, 2007

Office of Regulations and Interpretations  
Employee Benefits Security Administration, Room N-5669  
U.S. Department of Labor  
200 Constitution Avenue, N.W.  
Washington, DC 20210

Attention: Fee Disclosure RFI

Ladies and Gentlemen:

The Investment Company Institute<sup>1</sup> appreciates this opportunity to comment on the Department's Request for Information on fee and expense disclosure to participants in individual account plans. The Institute has long supported effective disclosure to participants and plan sponsors. The attached Policy Statement affirms that support and contains a chronology of the Institute's three decades of efforts to improve disclosure. In crafting 401(k) plan participant disclosure requirements, the Department should give priority attention to the following:

**Participants in all self-directed plans should receive simple, straightforward explanations about each investment option, including information on fees and expenses.** This should apply regardless of product type, and regardless of whether the plan sponsor intends to comply with the Department's regulation under section 404(c) of ERISA.

**Fees and expenses are only one piece of necessary information.** While the fees associated with a plan's investment options are an important factor participants should consider in making investment decisions, no participant should decide whether to contribute to the plan or allocate his or her account based solely on fees. In many plans the lowest fee option is a money market fund or other low-risk investment because these funds are the least costly to manage,<sup>2</sup> but it is not appropriate for

<sup>1</sup> ICI members include 8,766 open-end investment companies (mutual funds), 670 closed-end investment companies, 440 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$11.242 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.

<sup>2</sup> In 2005, the asset-weighted average total mutual fund expense ratio for money market funds held in 401(k) plans was 0.42%, compared with 0.58% for bond mutual funds and 0.76% for stock mutual funds. Holden and Hadley, *The*

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most participants to invest solely in these relatively lower return options. In plans offering investment in employer stock, the employer stock option fund may be the lowest fee option because essentially no active investment management is involved, but it also would not be appropriate for participants to invest solely in one security.<sup>3</sup> Any regulatory action by the Department to improve disclosure to participants in 401(k) plans should not place undue emphasis on fees over other vital pieces of information participants need to make informed investment decisions.

**While disclosure could be improved, the 401(k) system is working.** Institute research shows that participants generally make sensible choices in allocating their investments.<sup>4</sup> As we explain below, in the competitive mutual fund market, 401(k) savers also tend to concentrate their assets in low-cost funds. In 2005, 77% of stock mutual fund assets in 401(k) plans were invested in funds with a total expense ratio of less than 1.00%.<sup>5</sup> And collaborative research by the Institute and the Employee Benefit Research Institute demonstrates that a full career with 401(k) plans can produce adequate replacement rates at retirement.<sup>6</sup> The biggest challenge in ensuring adequate retirement security for all Americans lies in encouraging more small employers to offer a workplace plan. Disclosure reform should seek to improve the 401(k) system without imposing burdens, costs and liabilities that deter employers from offering plans.

**The Department's disclosure rules should codify best practices and leverage the Internet.** Mutual funds and other financial service providers active in the 401(k) market have developed innovative ways to present key investment information in a concise format that participants value and

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*Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, ICI Fundamentals, vol. 15, no. 7 (November 2006), available at <http://www.ici.org/pdf/fm-v15n7.pdf>.

<sup>3</sup> This point is made in the Department's publication for participants, *Taking the Mystery Out of Retirement Planning*, page 11, available at <http://www.dol.gov/ebsa/publications/NRTOC.html>.

<sup>4</sup> For example, in 2005, participants in their 20s allocated 62% of their accounts to pooled equity investments and company stock, and only about 20% to GICs and other fixed-income investments. Participants in their 60s allocated nearly 40% to GICs and other fixed-income investments. See Holden and VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2005*, ICI Perspective and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, August 2006, available at <http://www.ici.org/stats/rss/per12-01.pdf>. The 2005 EBRI/ICI database contains 47,256 401(k) plans with \$1,026 billion in assets and 17.6 million participants.

<sup>5</sup> See *Economics of Providing 401(k) Plans: Services, Fees and Expenses*, supra note 2.

<sup>6</sup> See Holden and VanDerhei, *Can 401(k) Accumulations Generate Significant Income for Future Retirees?* and *The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement*, ICI Perspective and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, November 2002 and July 2005, respectively, available at <http://www.ici.org/pdf/per08-03.pdf> and <http://www.ici.org/pdf/per11-02.pdf>, respectively. The latter research was cited in the Department's default investment proposal. See 71 Fed. Reg. 56806 n.1 (September 27, 2006).

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use. The Internet is a particularly effective and efficient means to deliver disclosure, because of its ability to offer layers of information.

**Disclosure rules should focus on the decisions participants have to make and the information they need to make those decisions.** The purposes behind fee disclosure to plan sponsors and participants differ. Participants have only two decisions to make: whether to contribute to the plan (and at what level) and how to allocate their account among the investment options the plan sponsor has selected. Disclosure should help participants make those decisions. Voluminous and detailed information about plan fees could overwhelm the average participant and could result in some employees deciding not to participate in the plan. On the other hand, plan sponsors, as fiduciaries, must consider additional factors in hiring and supervising plan service providers and selecting investment options. The Institute has consistently supported efforts to ensure plan sponsors have the detailed information they need as fiduciaries to select and monitor service providers and review the reasonableness of plan fees.<sup>7</sup> The Institute strongly supports the Department's decision to keep its project related to disclosure to plan fiduciaries under ERISA section 408(b)(2) distinct from this project related to participants.

Our responses to the Department's specific questions are below.

1. *What basic information do participants need to evaluate investment options under their plans? If that information varies depending on the nature or type of investment option (options offered by a registered investment company, options offered under a group annuity contract, life cycle fund, stable value product, etc.), please include an explanation.*

Participants should receive the following key pieces of information for each investment product offered under the plan:

- Types of securities held and investment objective of the product
- Principal risks associated with investing in the product
- Annual fees and expenses expressed in a ratio or fee table
- Historical performance
- Investment adviser that manages the product's investments

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<sup>7</sup> For example, see Statement of the Investment Company Institute on Disclosure to Plan Sponsors and Participants Before the ERISA Advisory Council Working Groups on Disclosure (September 21, 2004), available at [http://www.ici.org/statements/tmny/04\\_dol\\_krentzman\\_tmny.html](http://www.ici.org/statements/tmny/04_dol_krentzman_tmny.html).

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This list is informed by research on what information investors actually consider before purchasing mutual fund shares.<sup>8</sup> The top items shareholders considered in making decisions included fund fees and expenses, historical performance, risks associated with the fund, and types of securities in which the fund invests. Our research also found that investors find a summary of information more helpful than a detailed document.<sup>9</sup>

This basic information should be provided on all investment options available under the plan, regardless of type. Disclosure of this information is appropriate for mutual funds, insurance separate accounts, bank collective trusts, and separately managed accounts. In discussing fees and expenses, for example, the disclosure for any pooled vehicle should disclose the operating expenses of the pooled fund. In discussing the principal risks, the disclosure should explain the risks associated with the stated investment objectives and strategies.

The same key pieces of information are relevant and should be disclosed for fixed-return products, where a bank or insurance company promises to pay a stated rate of return. In describing fees and expenses of these products, for example, the disclosure should explain that the cost of the product is built into the stated rate of return because the insurance company or bank covers its expenses and profit margin by any returns it generates on the participant's investment in excess of the guaranteed rate of return. In describing principal risks of these products, the summary should explain that the risks associated with the guaranteed rate of return include the risks of interest rate changes, the long-term risk of inflation, and the risks associated with the product provider's insolvency.

2 *What specific information do participants need to evaluate the fees and expenses (such as investment management and 12b-1 fees, surrender charges, market value adjustments, etc.) attendant to investment options under their plans? If that information varies depending on the nature or type of option, or the particular fee arrangement relating to options (e.g., bundled service arrangements), please include an explanation.*

Participants should receive information on annual operating expenses<sup>10</sup> for any product where the investment return is based on the return of the underlying assets minus the operating expenses

<sup>8</sup> See *Understanding Investor Preferences for Mutual Fund Information*, Investment Company Institute (2006), available at [http://www.ici.org/pdf/rpx\\_06\\_inv\\_prefs\\_full.pdf](http://www.ici.org/pdf/rpx_06_inv_prefs_full.pdf). The study included in-home interviews with 737 randomly selected investors who had purchased shares in stock, bond, or hybrid mutual funds outside retirement plans at work in the preceding five years. Although this study focused on investors who purchased mutual funds in the retail market, we believe its findings are relevant to the decisions participants make in employer plans.

<sup>9</sup> Nearly nine in ten shareholders prefer a summary of mutual fund information, either by itself or along with a detailed document. See *Understanding Investor Preferences for Mutual Fund Information*, *supra* note 8.

<sup>10</sup> A mutual fund prospectus includes a standardized fee table that sets forth total expenses, which is the most relevant number to most investors. The fee table also breaks the total expense ratio into components—investment management,

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(including investment management, distribution expenses, mortality and expense (M&E) charges, insurance wrap fees, and bank insurance protection fees), as long as those expenses are being borne by the participant. This would include mutual funds, bank collective trusts, separately managed accounts, and variable insurance products. A product should not be exempt from this requirement solely because it has some insurance features, such as a death benefit or annuity right at distribution.

The needs of participants would be best served by *requiring* a simplified disclosure statement to include the total expense ratio. For most participants this is the key number. If the Department determines to require a breakdown of an expense ratio into constituent parts (such as the mutual fund expense ratio depicted in a mutual fund fee table), it should require the same of all similar investment products, to preserve comparability.

In addition, the Department should require disclosure of any transaction fees imposed at the time of purchase (brokerage or insurance commissions, sales charges or front loads<sup>11</sup>) or at the time of sale or redemption (redemption fees, deferred sales loads, surrender fees, market value adjustment charges). For products with these charges, it is important that participants be informed of them before investing.

Some "costs" of investing are not part of operating expenses, such as brokerage commissions. Instead, brokerage commission costs reduce the fund's capital gain (or increase capital loss) on a portfolio security investment. The effect of brokerage commissions and other trading costs are disclosed in fund performance, however. Mutual funds provide information on the fund's portfolio turnover rate in the prospectus and semi-annual shareholder reports and on brokerage commissions in the fund's Statement of Additional Information. While information on commissions could be helpful to a plan sponsor in selecting the plan's investment line-up, most participants will not find this information useful in making investment allocations.<sup>12</sup> This information should be available upon request or on the Internet.<sup>13</sup>

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distribution (12b-1), and other expenses. The fee table also discloses any transaction costs (e.g. sales charges) associated with investing in the fund.

<sup>11</sup> Front loads are not common in defined contribution plans. As of 2005, almost three-quarters of mutual fund assets in 401(k) plans were held in no-load funds. The remaining one-quarter was held in load funds, but predominately in fund shares that do not charge retirement participants a front-end load. See *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, supra note 2.

<sup>12</sup> Other so-called transaction costs, such as "spread costs," "market impact costs," and "opportunity costs," cannot be quantified and expressed with accuracy. These costs are disclosed indirectly, however, in fund performance information. See Institute Letter to the SEC re: Commission Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs (File No. S7-29-03) (February 23, 2004), available at: [http://www.ici.org/statements/cmltr/2004/04\\_sec\\_port\\_disclose\\_com.html](http://www.ici.org/statements/cmltr/2004/04_sec_port_disclose_com.html).

<sup>13</sup> Any disclosure requirements imposed by the Department regarding trading costs should apply to all investment options where trading affects the product's investment return.

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3. *To what extent is the information participants need to evaluate investment options and the attendant fees and expenses not currently being furnished or made available to them? Should such information be required to be furnished or made available by regulation or otherwise? Who should be responsible for furnishing or making available such information? What, if any, additional burdens and/or costs would be imposed on plan sponsors or plans (plan participants) for such disclosures?*

As the Government Accountability Office found, current disclosure rules produce uneven disclosure, depending both on whether the plan seeks to comply with ERISA section 404(c) and whether an investment option is registered under the Securities Act of 1933.<sup>14</sup> One important gap is that plans that do not rely on section 404(c) are not required to provide any particular investment information to participants. In plans complying with section 404(c), the Department does not currently require that participants receive annual fee or historical return information unless they affirmatively ask for it (and then only if the plan has that information). On the other hand, participants automatically receive this information with respect to mutual funds and other products registered under the 1933 Act because the Department requires that they receive a prospectus. In practice, some providers of stable value funds or other pooled products that are not registered under the 1933 Act provide disclosure modeled on mutual fund disclosures, while others provide narrative information which may only contain some of the information mutual fund investors receive.

Plans should be *required* to provide the key investment information for each investment option. The plan administrator (or other designated plan fiduciary) should have the obligation to provide this information, although financial service providers and retirement plan recordkeepers will continue to play a role in producing this information in a form that can be given to participants.

The costs associated with disclosure generally are paid by participants, through increased investing costs, increased account charges, or a decrease in another component of employee compensation. We believe that the changes we recommend will not impose material costs or significant burdens. In section 404(c) plans, the identified plan fiduciary (typically the plan administrator) already has an obligation to provide information for each investment option about investment objectives, risk and return characteristics, the identity of the investment manager, and transaction fees associated with the product. Adding historical performance and annual fees to that list should not impose significant burdens on plan fiduciaries or require product providers to incur costs in deriving this information.

Voluminous and detailed additional disclosure, on the other hand, could create substantial burdens on plan sponsors, service providers, and investment products. For example, individualized disclosure of what a participant paid on a dollar basis would involve costly systems changes that would

<sup>14</sup> Government Accountability Office, *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees*, GAO-07-21 (November 2006), pp 18-19.



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outweigh any benefit from this information. See answer to question #19, below. This is especially true where plan investment options come from a number of different providers.

4. *Should there be a requirement that information relating to investment options under a plan (including the attendant fees and expenses) be provided to participants in a summary and/or uniform fashion? Such a requirement might provide that: A) all investment options available under a participant-directed individual account plan must disclose information to participants in a form similar to the profile prospectus utilized by registered investment companies; or B) plan fiduciaries must prepare a summary of all fees paid out of plan assets directly or indirectly by participants and/or prepare annually a single document setting forth the expense ratios of all investment options under the plan. Who should be responsible for preparing such documents? Who should bear the cost of preparing such documents? What are the burden/cost implications for plans of making any recommended changes?*

As stated above, we believe that participants should receive a summary with the key information for each investment option. The mutual fund profile permitted by Rule 498 under the Securities Act of 1933 (sometimes called the profile prospectus) is one way to provide summary information on mutual funds, but it is not the only way.

It is common practice today to provide a "fund fact sheet" to 401(k) participants, although a fund profile is sometimes used instead. These helpful tools, which are typically limited to one or two pages, provide basic information about a fund's investment objectives, risk, historical performance, and fees, in a format that investors find useful. They often use charts and graphs, which investors prefer over narrative descriptions.<sup>15</sup> The SEC is developing a new streamlined disclosure document for mutual funds.<sup>16</sup> (SEC rules for using the document are expected to address liability issues that prevented the fund profile from gaining wide use.)

These concise documents could serve as models for other products. We understand that the Department has begun coordination with the SEC. It is critical that any simplified disclosure document that the SEC develops for mutual funds be consistent with what the Department requires in the context of 401(k) investors; otherwise, 401(k) investors will bear the costs of mutual funds operating under different disclosure regimes.

The Department should not mandate that participants receive a list showing only the investment options under the plan and the expense ratio for each. Without the context of other key

<sup>15</sup> See *Understanding Investor Preferences for Mutual Fund Information*, supra note 8.

<sup>16</sup> See Statement of Securities Exchange Commission Before the House Financial Services Committee (June 26, 2007), available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/sec\\_testimony\\_6-26-07.pdf](http://www.house.gov/apps/list/hearing/financialsvcs_dem/sec_testimony_6-26-07.pdf).

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investment information—objectives, risks, historical performance—a list of this sort will elevate fees as a consideration above all else, and encourage inappropriate investment decisions.

Fee information should always be disclosed in the context of the other key information participants need to make good investment decisions. Many plans make available only one investment option for a particular asset class or investing style. For example, there may be only one large cap growth stock fund, one small cap stock fund, one money market fund, one suite of lifecycle funds, etc. The average investor gains little from knowing that the plan's lifecycle retirement fund has an expense ratio of 0.75%, the money market fund has an expense ratio of 0.40%, and the plan's employer stock option has a zero expense ratio. Participants in these plans who look only at fees likely will make inappropriate long-term asset allocations.

Institute research shows that retail mutual fund investors routinely consider other factors such as risks and historical performance in addition to fees before purchasing mutual fund shares.<sup>17</sup> The Department should not mandate that 401(k) participants receive a document that implies they should consider only one piece of information.

5. *How is information concerning investment options, including information relating to investment fees and expenses, communicated to plan participants, and how often? Does the information or the frequency with which the information is furnished depend on whether the plan is intended to be a section 404(c) plan?*

Many Institute members that offer recordkeeping services to 401(k) plans provide the employer with "fund fact sheets" for each investment option under the plan. These fund fact sheets typically are available on a website maintained for the plan, so anytime a participant logs in he or she can access basic information about the plan's options (including those in which he or she is not invested). Disclosures similar to mutual fund fact sheets are often provided for stable value funds or other pooled products, although there tends to be less uniformity regarding products other than mutual funds.

Some fund fact sheets provide a breakdown of a fund's expense ratio (by investment management, distribution (12b-1) and other administrative expenses). Other fund fact sheets simply disclose the total expense ratio. For most investors, the total expense ratio is the key number, and additional breakdown is available in the fund's prospectus.

We understand from our members that the information or the frequency with which the information is furnished generally does not depend on whether the plan sponsor has determined the plan is a section 404(c) plan. Recordkeepers and third party administrators design their recordkeeping

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<sup>17</sup> See *Understanding Investor Preferences for Mutual Fund Information*, supra note 8.

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systems, call centers, voice response systems, and websites to comply with section 404(c) disclosure requirements.

6. *How does the availability of information on the internet pertaining to specific plan investment options, including information relating to investment fees and expenses, affect the need to furnish information to participants in paper form or electronically?*

Because of the increasing availability and use of the Internet, any rules issued by the Department should encourage and facilitate electronic disclosure of investment information. Web-based layered disclosure gives 401(k) participants both basic information and, for those seeking it, the ability to "click through" to more detail. The Department's rules should allow plans to make detailed information and documents, such as the mutual fund prospectus, available online or in paper upon request. Plans also should be able to provide the basic summary information that we recommend for every single investment option online, unless an employee does not have reasonable access to the Internet.<sup>18</sup>

Access to the Internet is growing dramatically. The Institute has conducted extensive research on access to and use of the Internet by U.S. households generally and mutual fund investors specifically. An Institute study from 2005 reports that four out of five Americans have Internet access, up from less than one-quarter of Americans in 1997.<sup>19</sup> Among certain groups, such as those with a college education, Internet access is nearly universal, but Internet access also has grown significantly among other groups. For example, 64 percent of U.S. adults with a high school education or less report having Internet access in 2005, as compared to 10 percent in 1997. Only 8 percent of people age 55 or older had Internet access in 1997—by 2005, the number grew to 64 percent. Among those with a household income below \$50,000, the share with Internet access grew from 14 percent to 64 percent in that period (1997–2005).<sup>20</sup>

A 2006 Institute study of Americans who own mutual funds (whether through employer plans or through the retail market) found that over 90 percent have access to the Internet. The study found that 71 percent of those with Internet access go online at least once a day. Three-quarters of

<sup>18</sup> The Report of the 2006 ERISA Advisory Council's Working Group on Prudent Investment Process also recommended relaxing the Department's rules for electronic disclosure by moving to a "reasonable access" model. See [http://www.dol.gov/ebsa/publications/AC\\_1106A\\_report.html](http://www.dol.gov/ebsa/publications/AC_1106A_report.html).

<sup>19</sup> See West and Leonard-Chambers, *Mutual Fund Shareholders' Use of the Internet, 2005*, ICI Fundamentals, vol. 15, no. 2 (February 2006).

<sup>20</sup> See *Mutual Fund Shareholders' Use of the Internet, 2005*, supra note 19.

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shareholders who go online use the Internet to access their bank or investment accounts, and 57 percent use the Internet to obtain investment information.<sup>21</sup>

Most 401(k) plan recordkeepers maintain a website that gives participants continuous access to their accounts, continuous access to information about the plan's investment options, and easy access to plan features. Many participants enroll online using this system, and at the time of enrollment, have web access to the key information about each investment option. Often each investment option's key features are provided through interactive web pages, allowing "click through" to more detail and additional documents like prospectuses and annual reports.

Our research finds that shareholders prefer a summary of mutual fund information instead of a detailed document. Only 34 percent of mutual fund shareholders surveyed indicated that they consulted the prospectus before making their most recent purchase of fund shares. About half indicated they generally do not read or read very little of the prospectus they receive.<sup>22</sup>

Plans should have the option to make more detailed documents—such as mutual fund prospectuses and similar investor reports for other commingled products and insurance products—available online or in paper upon request.

7. *What changes, if any, should be made to the section 404(c) regulation, to improve the information required to be furnished or made available to plan participants and beneficiaries, and/or to improve likelihood of compliance with the disclosure or other requirements of the section 404(c) regulation? What are the burden/cost implications for plans of making any recommended changes?*

As an initial matter, the Department should take the basic disclosure obligations out of section 404(c) and apply them to all participant-directed defined contribution plans. See answer to question #15, below.

The current 404(c) disclosure rules impose special requirements on mutual funds and other investments subject to the Securities Act of 1933. For these investment options, plans must provide participants with a copy of the fund's prospectus, which contains all the key information, including fees and historical performance. For other investment options, key information, such as annual operating expenses and historical performance, is required to be provided only upon request and only if that information has been provided to the plan.

<sup>21</sup> See West and Leonard-Chambers, *Ownership of Mutual Funds and Use of the Internet*, 2006, ICI Fundamentals, vol. 15, no. 6 (October 2006).

<sup>22</sup> See *Understanding Investor Preferences for Mutual Fund Information*, *supra* note 8.

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The Report of the 2006 ERISA Advisory Council's Working Group on Prudent Investment Process explained the gaps in the section 404(c) regulation this way:

"Overall, the testimony received told the Working Group that the current disclosure system results in significant gaps in the information that participants receive about some products and can produce information overload with respect to other products. Several witnesses testified that while mutual funds are the easiest investment to understand by participants – mutual funds have the heaviest burden when it comes to disclosure. By the same token less regulated and harder to understand investments might not even provide information regarding fees and performance."<sup>23</sup>

8. *To what extent should participant-directed individual account plans be required to provide or promote investment education for participants? For example, should plans be required or encouraged to provide a primer or glossary of investments-related terms relevant to a plan's investment options (e.g., basis point, expense ratio, benchmark, redemption fee, deferred sales charge); a copy of the Department's booklet entitled "A Look at 401(k) Fees" ([http://www.dol.gov/ebsa/publications/401k\\_employee.html](http://www.dol.gov/ebsa/publications/401k_employee.html)) or similar publication; or investment research services? Should such a publication include an explanation of other investment concepts such as risk and return characteristics of available investment options? Please explain views, addressing costs and other issues relevant to adopting such a requirement.*

It is common for plans to provide or promote investment education to participants.<sup>24</sup> The Department should encourage participant education, including through its own website, but should not mandate specific requirements.

Plan sponsors and service providers have long supported investment education for participants and mutual fund companies have been leaders and innovators in helping savers understand investing concepts. The Department provides various participant and sponsor education materials, including its "A Look at 401(k) Fees." Employers, service providers, and the Department all play a role in helping participants understand their plan, its investment options, and basic savings and investment concepts. The Department should continue to promote investment education, and continue to partner with stakeholders, but should not stifle innovation with mandates.<sup>25</sup>

<sup>23</sup> Report of the 2006 ERISA Advisory Council's Working Group on Prudent Investment Process, available at [http://www.dol.gov/ebsa/publications/AC\\_1106A\\_report.html](http://www.dol.gov/ebsa/publications/AC_1106A_report.html).

<sup>24</sup> See, e.g., Profit Sharing/401(k) Council of America (PSCA), *49th Annual Survey, Reflecting 2005 Plan Year Experience*.

<sup>25</sup> A mandate to provide investment education could lead plan fiduciaries to deluge participants with investment materials to ensure the plan has complied with the mandate.

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Some plan sponsors and service providers may wish to develop their own materials and have the resources to do so. Others, especially small plans, may want to refer participants to the Department's materials. Both approaches provide participants access to cost-effective education.

The Pension Protection Act requires that a participant's periodic pension benefit statement include an explanation of the importance of a well-balanced portfolio, including a statement that holding more than 20 percent of a portfolio in the security of one entity (such as employer securities) may not be diversified and a notice directing the participant to the Department's website for sources of information on individual investing and diversification. The Department's current website used to comply with the PPA<sup>26</sup> includes a link to the Department's booklet on 401(k) fees, which is provided alongside other useful publications to help participants get the most out of their 401(k) plans. This approach recognizes that fees, while important, are only one piece of information that participants should consider.

9. *What information is currently furnished to participants about the plan and/or individual administrative expenses charged to their individual accounts? Such expenses may include, for example: audit fees, legal fees, trustee fees, recordkeeping expenses, individual participant transaction fees, participant loan fees or expenses.*

Where participants are assessed an overall administrative charge to their account (such as \$100 per year) which is not already reflected in the fees of the plan's investment options, that charge typically is shown on the participant's quarterly statement and may be disclosed to participants in some form at enrollment.

The Department should require that any administrative charge assessed directly against the participant's account, and not reflected in the fees of the investment products available under the plan, be provided upon enrollment, or within a reasonable time thereafter. If the exact amount of the upcoming year's charge cannot be determined in advance, because the amount charged will depend on the actual expenses incurred by the plan's trust, then an estimate should be provided.

Where an administrative charge is assessed to participants, it would not typically be divided into its constituent parts (such as recordkeeping, audit, trustee, or compliance).<sup>27</sup> The charge covers all the services that the plan fiduciary has hired the service provider(s) to provide. Breaking the administrative fee into constituent parts makes no more sense than a restaurant disclosing how much of the cost of a hamburger goes to pay for the bun, the meat, the lettuce, the ketchup, the wait service, and the dishwashing.

<sup>26</sup> See <http://www.dol.gov/ebsa/investing.html>. See also Field Assistance Bulletin 2006-3 (December 20, 2006).

<sup>27</sup> Plan participants play no role in negotiating the details of service arrangements and would have no context by which to judge the reasonableness of each constituent charge.

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Individual participant transaction-based charges, such as loans or QDRO fees, are typically disclosed prior to a participant accessing that plan feature. Our members that provide recordkeeping services inform us that the fee also appears on the confirmation that is typically provided to participants (either by mail or electronically) after the service is accessed. The charge typically also will be shown on the quarterly statement. The Department should not require that these participant-initiated charges be disclosed at enrollment, but instead when the participant accesses the plan feature.

10. *What information about administrative expenses would help plan participants, but is not currently disclosed? Please explain the nature and usefulness of such information.*

The key piece of information for participants is what charges will be assessed against their accounts in addition to any annual fees and transaction fees associated with the investment options they select. Some participants may not understand that the fees and expenses of the investment options may pay for both investment services and administrative services. To address this issue, the Department could mandate that participants be told, if it is the case, that a portion of the fees and expenses associated with the investment products are used to defray the cost of administering the plan and meeting regulatory requirements.

The information needs of plan participants and plan sponsors are quite different. Detailed information about plan administrative costs and how fees and expenses are allocated among service providers will not help a participant make decisions as to how much to contribute to the plan and how to allocate his or her account. This information would be available to a participant who wishes to review it, for example, on the new Schedule C to Form 5500 proposed by the Department. Plans are required to provide Form 5500 to any participant who asks for it (and the summary annual report alerts participants to this fact).

11. *How are charges against an individual account for administrative expenses typically communicated to participants? Is such information included as part of a participant's individual account statement or furnished separately? If separately, is the information communicated via paper statements, electronically, or via website access?*

See answer to question #9, above. Some participants access their account statements online, or choose to receive statements electronically, in which case the information that is disclosed on the quarterly statement is also available via email or website access.

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*12. How frequently is information concerning administrative expenses charged to a participant's account communicated?*

Administrative charges that are not already reflected in the plan's investment options are typically disclosed on the quarterly benefit statement. See answer to question #9, above. In addition, participants served by our members will see the charge reflected in their online account when the charge is assessed.

Where administrative expenses are part of the fees of the individual products, disclosure of those fees will be disclosed in conjunction with the investment product. For example, any fees of a mutual fund that are used to defray administrative expenses of the plan will be reflected in the expense ratio disclosed prominently in the fund's prospectus, and under our recommendation, will be included in the fund fact sheet or fund profile provided to participants upon enrollment. As suggested above, the Department could require that participants be told, if it is the case, that a portion of the fees and expenses of the investment products are used to defray the cost of administering the plan and meeting regulatory requirements.

*13. What, if any, requirements should the Department impose to improve the disclosure of administrative expenses to plan participants? Please be specific as to any recommendation and include estimates of any new compliance costs that may be imposed on plans or plan sponsors.*

See answer to question #9, above.

*14. Should charges for administrative expenses be disclosed as part of the periodic benefit statement required under ERISA section 105?*

Any individual charges to a participant's account incurred during the quarter should be disclosed in the periodic benefit statement. The periodic benefit statement, however, is not the place for duplicate disclosure of fees associated with each investment option. The fund's performance, and therefore the participant's account, will already reflect the fees of the investment option.

Disclosure of fees associated with the plan's investment options on the periodic benefit statement could elevate fees above other important factors and encourage inappropriate investment allocations, just as it could upon enrollment. In addition, the periodic benefit statement covers only those investments in which the participant has invested, and not others available under the plan. Participants would be much better served by having access to updated copies of the fund fact sheets, either through the plan's website or in paper upon request.



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15. *What, if any, distinctions should be considered in assessing the informational needs of participants in plans that intend to meet the requirements of section 404(c) as contrasted with those of participants in plans that do not intend to meet the requirements of section 404(c)?*

There is no reason to differentiate the *information* needs of participants in section 404(c) plans versus those in non-section 404(c) plans. There is no policy justification to deny participants who have the right under the plan to direct the investment of their account the key information they need to make informed decisions.

16. *What (and what portion of) plan administrative and investment-related fees and expenses typically are paid by sponsors of participant-directed individual account plans? How and when is such information typically communicated to participants?*

According to a survey conducted by Deloitte Consulting, LLP, International Foundation, and the International Society of Certified Employee Benefit Specialists, more than one-third (37 percent) of plan sponsors indicated that the company (plan sponsor) paid for all administrative and recordkeeping expenses:<sup>28</sup>

**WHO PAYS ANNUAL 401(k) RECORDKEEPING/ADMINISTRATIVE FEES?**  
Percent of plans surveyed,<sup>1</sup> 2005

	Percent
Plan Sponsor	37
Participant	55
via Investment Product Fees and Expenses <sup>2</sup>	38
via Additional Reduction to Investment Returns <sup>2</sup>	5
via Direct Charge	12
Pro rata based on account balances	8
Equal dollar to all participants	4
Direct Fees Paid by Both Plan Sponsor and Participant	4
Other	4

<sup>1</sup>The survey covers 830 401(k) plan sponsors.

<sup>2</sup>Although reported separately in this survey, these two components are generally combined and included in the fees and expenses of the investment option.

Sources: Investment Company Institute tabulation of data from Deloitte Consulting LLP, International Foundation, and International Society of Certified Employee Benefit Specialists, Annual 401(k) Benchmarking Survey 2005/2006 Edition

<sup>28</sup> See *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, supra note 2.

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17. *How would providing additional fee and expense information to participants affect the choices or conduct of plan sponsors and administrators, and/or that of vendors of plan products and services? Please explain any such effects.*

Mutual fund companies and other financial service providers already create and provide fund fact sheets or fund profiles with key investment information, including fees. Changes we recommend should not significantly affect their costs or behavior.

Transparency promotes competition, which inures to the benefit of plans and participants. Although the disclosures we have discussed are designed for participants, availability of comparable streamlined disclosure about all investment products that includes performance, fees, risks and objectives, will help plan sponsors select and monitor the plan menu. This is especially important for plans that do not employ independent consultants to assist them in evaluating service arrangements and investments.

However, disclosure overload may deter employers from offering plans or result in additional plan recordkeepers leaving the business.<sup>29</sup> Disclosure requirements with voluminous and detailed disclosure for each participant will require significant investment in recordkeeping systems that small or low margin service providers will be less able to absorb. See question #19, below. While all compliance costs create barriers to entry, disclosure requirements entailing expensive computer systems and interlocking data exchange could particularly affect smaller service providers.

18. *How would providing additional fee and expense information to participants affect their plan investment choices, plan savings conduct or other plan related behavior? Please explain any such effects and provide specific examples, if available.*

The Institute believes that transparency of the kind we have recommended allows the market to work. Mutual fund fees are transparent and widely available in prospectuses, fund fact sheets, and reporting services, and the fees incurred by investors have declined significantly. Our latest research finds that mutual fund fees and expenses that investors paid fell to their lowest levels in more than a quarter century in 2006, continuing a trend observed since the early 1980's.<sup>30</sup> In short, mutual fund investors, and 401(k) investors, concentrate their assets into low-cost funds.

<sup>29</sup> See "Rapid 401(k) Consolidation Shrinks Employer Options," *Employee Benefit News*, April 1, 2007; "Recordkeeper Consolidation Takes Center Stage," *Defined Contribution & Savings Plan Alert*, December 25, 2006; "401(k) Administration Rapidly Consolidating," *Money Management Executive*, December 11, 2006.

<sup>30</sup> See Collins, *Fees and Expenses of Mutual Funds, 2006*, ICI Fundamentals, vol. 16, no. 2 (June 2007), available at <http://www.ici.org/pdf/fm-v16n2.pdf>.

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In 2005, the average stock mutual fund had an expense ratio of 1.54%. But on an *asset-weighted basis*, the average expense ratio incurred by mutual fund investors in stock mutual funds was 0.91%. And the asset-weighted average expense ratio for 401(k) investors was even lower: 0.76%. Similar results can be seen in each broad type of stock fund, as well as in bond funds.<sup>31</sup>

**401(k) STOCK MUTUAL FUND ASSETS ARE CONCENTRATED IN LOW-COST FUNDS**

Percent of 401(k) stock mutual fund assets, 2005



\*The total expense ratio, which is reported as a percentage of fund assets, includes fund operating expenses and 12b-1 fees. Note: Figures exclude mutual funds available as investment choices in variable annuities.

Sources: Investment Company Institute and Lipper

Several factors contribute to the relatively low average expense ratios incurred by 401(k) plan participants investing in mutual funds. Plan sponsors play a vital role in selecting and regularly evaluating the plan's investment line-up to ensure that each option's fees and expenses provide good value. Easy access to comparable and transparent mutual fund fee information helps employees in selecting investments for their accounts.

The Pension Protection Act added a significant number of new notices that participants must receive, especially where the plan uses automatic enrollment and default investments. Some of these notices are under the jurisdiction of the Department while some are under the jurisdiction of the Department of Treasury and the Internal Revenue Service.<sup>32</sup> The Department should work with Treasury and IRS to consolidate these notices wherever possible.

Sending a large number of discrete notices raises the risk that participants will stop paying attention to them. This will undermine rather than enhance transparency.

<sup>31</sup> See *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, supra note 2.

<sup>32</sup> The Internal Revenue Service has already issued some guidance regarding fee disclosure in the context of the notice required under section 402(f) of the Internal Revenue Code. See Notice 2007-7, Q&A-33. We strongly suggest the Department work with IRS in coordinating any fee disclosure requirements.

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19. *Please identify any particularly cost-efficient (high-value but inexpensive) fee and expense disclosures to participants, and to the contrary any particularly cost-inefficient ones. Please provide any available estimates of the dollar costs or benefits of such disclosures.*

A high-value cost-effective disclosure regime would provide participants with streamlined, comparable information about investment products and any additional plan charges. This disclosure will address their need to make investment choices and periodically monitor their accounts. The Department should provide flexibility to plan sponsors and service providers on the format of disclosure. The Department should also allow electronic delivery and permit plan sponsors and service providers to leverage the Internet to make additional information on the options available electronically or in paper upon request.

In contrast, two other approaches would be very cost inefficient. First, the Department should not require detailed disclosure to participants about service provider arrangements and costs, comparable to the information the employer receives. As we have discussed above, this information will not help the participant make proper account investment allocations, will impose unnecessary costs and could discourage employee participation in plans.

The Department also should not require dollar amount disclosure of product fees attributable to an individual participant. Currently, this is not something the investment provider or recordkeeper can typically calculate, and it would be very expensive to design and implement systems and processes to produce this information.

The SEC looked at this issue in the context of disclosure of mutual fund fees. A June 2000 General Accounting Office (now Government Accountability Office) report on mutual fund fees suggested various approaches to improving fee disclosure, one of which was to require that funds calculate and disclose to each fund investor the actual dollar amount of fund operating expenses attributable to that investor.<sup>33</sup> The SEC examined the GAO's report and concluded that the best way to improve shareholder understanding was to require a fee example in shareholder reports showing the expenses paid on each \$1,000 invested, based both on the fund's actual operating expenses and actual return for the period and, to allow comparisons among funds, based on an assumed return of 5 percent per year.<sup>34</sup>

In its adopting release, the SEC cited Institute research concluding that the aggregate costs to survey respondents associated with calculating and disclosing individualized fund expenses would be

<sup>33</sup> See General Accounting Office, "Mutual Fund Fees: Additional Disclosures Could Encourage Price Competition" (June 2000), available at <http://www.gao.gov/new.items/g00126.pdf>.

<sup>34</sup> See Securities and Exchange Commission, Final Rule, Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, 69 Fed. Reg. 11244 (March 9, 2004).

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\$200.4 million in initial implementation and \$65 million in annual, ongoing costs.<sup>35</sup> This estimate covered only the costs for calculation and disclosure to retail investors. Providing this type of disclosure in 401(k) plans would be even more costly because a plan sponsor or recordkeeper must consolidate fee and account information with respect to each investment in a participant's account, information that derives from different sources. Current recordkeeping systems are not designed to receive the needed information from mutual fund companies and other financial product providers on a daily basis.

If the Department believes that reducing asset-based charges into estimated dollar amounts is necessary for participants to understand adequately their fees, the Department should follow the model that accompanies the fee table in a mutual fund prospectus or the example in a fund's shareholder reports.<sup>36</sup>

The mutual fund industry is committed to meaningful disclosure. Over the past 30 years, the Institute has supported efforts to improve the quality of information provided to plans and participants and the way in which that information is presented. We look forward to continuing to work with the Department. If you have any questions, please contact the undersigned at 202-326-5826 or Michael Hadley at 202-326-5810.

Sincerely,

/s/ Mary Podesta

Mary Podesta  
Senior Counsel – Pension Regulation and  
Acting General Counsel

Attachment (ICI Board Policy Statement)

<sup>35</sup> The Institute survey was conducted in 2000, and included responses from 39 mutual fund complexes with total net assets of \$4.8 trillion (approximately 77 percent of total industry net assets as of June 2000).

<sup>36</sup> A mutual fund's prospectus provides a quantitative example showing the dollar amount of expenses an investor would pay on a hypothetical \$10,000 investment that earns 5 percent annually over 1-, 3-, 5- and 10-year periods. This calculation number takes into account any sales charges imposed by the fund. The fund's semi-annual and annual reports include a table showing the expenses paid on each \$1,000 invested, based both on the fund's actual operating expenses and actual return for the most recent six-month period and, to allow comparisons among funds, based on an assumed return of 5 percent per year.



## **401(k) Participants' Awareness and Understanding of Fees**

July 2007



## **401(k) PARTICIPANTS' AWARENESS AND UNDERSTANDING OF FEES**

**JULY 2007**

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AARP collected the data for this study through an online survey administered by Knowledge Networks of Menlo Park, California. Thanks go to the following AARP staff members who provided input for this study: Michael Herndon, Clare Hushbeck, Evelyn Morton, Mitja Ng-Baumhackl, Shaun O'Brien, Jo Reed, Sara Rix, Amy Shannon, Mary Ellen Signorille, Nancy Smith, Jay Sternberg, Jay Sushelsky, Colette Thayer, Frank Toohey, and Ryan Wilson. The report was prepared by S. Kathi Brown, AARP Strategic Issues Research. For additional information, contact S. Kathi Brown at (202) 434-6296.



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## I. EXECUTIVE SUMMARY AND IMPLICATIONS

Many 401(k) participants lack basic knowledge of the fees associated with their plans even though nearly eight in ten (79%) plan participants who make decisions about their 401(k) investments noted that fees are an important consideration in their decisions. For example, more than eight in ten (83%) participants acknowledged that they actually do not know how much they pay in fees and expenses associated with their own plan. Additionally, more than half (54%) of participants do not feel knowledgeable about the impact that fees can have on their retirement savings.

Despite the lack of knowledge about fees, many respondents do appear to sense that fees can have a significant effect on their returns. Specifically, when asked to choose between two different funds that were described as identical with the exception of the expense ratio, the majority of respondents selected the fund with the lower expense ratio. Furthermore, the majority express a desire to have a better understanding of the long-term impact of fees.

Respondents report a preference for receiving information about fees on paper rather than electronically or over the phone and express an interest in receiving this information both before they choose their 401(k) investments as well as on a regular basis thereafter. When asked who should be most responsible for ensuring that participants understand fees charged by plans, 401(k) plan participants are most likely to identify employers that sponsor plans (36%) followed by the financial services companies that administer the plans (32%) and 401(k) participants themselves (28%).

### Implications

401(k) participants appear to understand that fees should be an important consideration in their investment decisions and that fees have the potential to affect their return on investment. However, the lack of knowledge about fees coupled with the expressed desire for a better understanding of fees points to a need to ensure that information about plan fees is distributed regularly and in plain English to current and prospective plan participants. AARP recommends that fee information be presented in a chart or graph that depicts the effect that the total annual fees and expenses can have on a participant's account balance in a year as well as over the long term. Including such information about fees may help current and prospective plan participants make better choices about their investments.

Furthermore, in-person financial education may also add to the value of written information as demonstrated by the fact that approximately one in four survey respondents expressed an interest in receiving fee information either in a group information session or in a one-on-one counseling session. Finally, any fee information provided in writing should also direct plan participants to how they may obtain more detailed information on their investment options and fees.

## II. BACKGROUND AND METHODOLOGY

In recent years, 401(k) retirement savings plans and other defined contribution plans have become increasingly common. According to a recent study, the number of participants in 401(k) plans grew from under 8 million in the mid-1980s to approximately 47 million by 2005, and the amount invested in these plans grew from less than \$100 billion to over \$2 trillion over the same period.<sup>1</sup> Furthermore, more than 60 percent of workers with pension coverage in 2003 had *only* a 401(k) plan or other defined contribution plan, which suggests that worker reliance on defined contribution plans has increased considerably since 1981 when just under 20 percent of workers with pension coverage had only a 401(k) plan or other defined contribution plan.<sup>2</sup> Moreover, roughly 87 percent of all 401(k) plans-- covering 92 percent of all 401(k) plan participants-- are participant-directed, meaning that the participant makes decisions about his or her contributions to the plan.<sup>3</sup>

In light of the prevalence of 401(k) plans and the critical role that 401(k) plans can play in an individual's retirement security, AARP commissioned a nationally representative survey of 1,584 401(k) plan participants ages 25 and older in order to gauge awareness and knowledge of fees and expenses charged by 401(k) plan providers. The survey was fielded from June 8<sup>th</sup> through June 24<sup>th</sup>, 2007 by Knowledge Networks of Menlo Park, California, to members of its nationally representative online panel.

The overall sample was designed to be nationally representative of 401(k) plan participants age 25 and older. In order to achieve this representation of 401(k) plan participants ages 25+, the sample was first weighted by gender, age, race/ethnicity, education, census region, and metropolitan area using benchmark data for adults ages 25 and older from the U.S. Census Bureau's Current Population Survey (CPS). Because survey respondents were screened to eliminate those who do not have a 401(k) plan, the initial weighting to CPS benchmarks also results in sample demographics that correctly reflect the age distribution of 401(k) plan participants ages 25 and older. Screening data rather than data from other sources, such as the CPS, were used to obtain benchmarks for 401(k) participants ages 25 and older due to the lack of suitable demographic benchmarks from other sources for individuals who participate in 401(k) plans.

Due to AARP's particular interest in the population ages 50+, the survey includes an oversample of plan participants ages 50 and older. However the overall sample has been adjusted through weighting to be representative of 401(k) plan participants ages 25 and older as noted above. Therefore, although the unweighted sample includes 758 respondents ages 25 to 49 and 826

<sup>1</sup> See Sara Holden and Jack VanDerhei, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2005," *Research Perspective*, vol. 12, no. 1 (2006), as cited in Government Accountability Office, *Private Pensions: Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees* (Nov. 2006).

<sup>2</sup> Center for Retirement Research at Boston College, *The State of Private Pensions: Current 5500 Data*, (February 2006). [http://www.bc.edu/centers/crr/ib\\_42.shtml](http://www.bc.edu/centers/crr/ib_42.shtml)

<sup>3</sup> Government Accountability Office, *Private Pensions: Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees* (Nov. 2006).

respondents ages 50 and older, the weighting that was applied to make the sample representative of 401(k) plan participants ages 25+ effectively reduces the respondents ages 50+ to 36 percent of the sample and ensures that the overall sample does not overrepresent individuals ages 50+.

### **III. DETAILED FINDINGS**

#### **How Do 401(k) Plan Participants Make Investment Decisions?**

The majority of 401(k) participants (87%) report that they are involved in making decisions related to the investments in their 401(k) plan, including nearly four in ten (38%) who make all investment decisions entirely on their own. Just over one in ten (13%) indicate that they are not at all involved in investment decisions for their plans.

#### **Sources of Information and Advice**

When asked to identify the materials that they turn to for guidance when making decisions, more than half (57%) of respondents who are involved in investment decisions for their 401(k) plan indicate that they refer to summary information about the plan's investment choices. Other materials used include prospectuses (34%), research analyst's recommendations (22%), financial magazine articles (17%), and financial shows on TV (14%). Additionally, approximately one third (34%) of those involved in investment decisions refer to the Internet for information. Among those who utilize the Internet, the web sites of their 401(k) plan providers are most widely used, followed by news web sites.

Among respondents who seek advice from other people, the most common sources of advice include personal financial advisors (30%), employer-provided financial advisors (30%), spouses (30%), other family members (25%), and friends (21%).

#### **Importance of Fees**

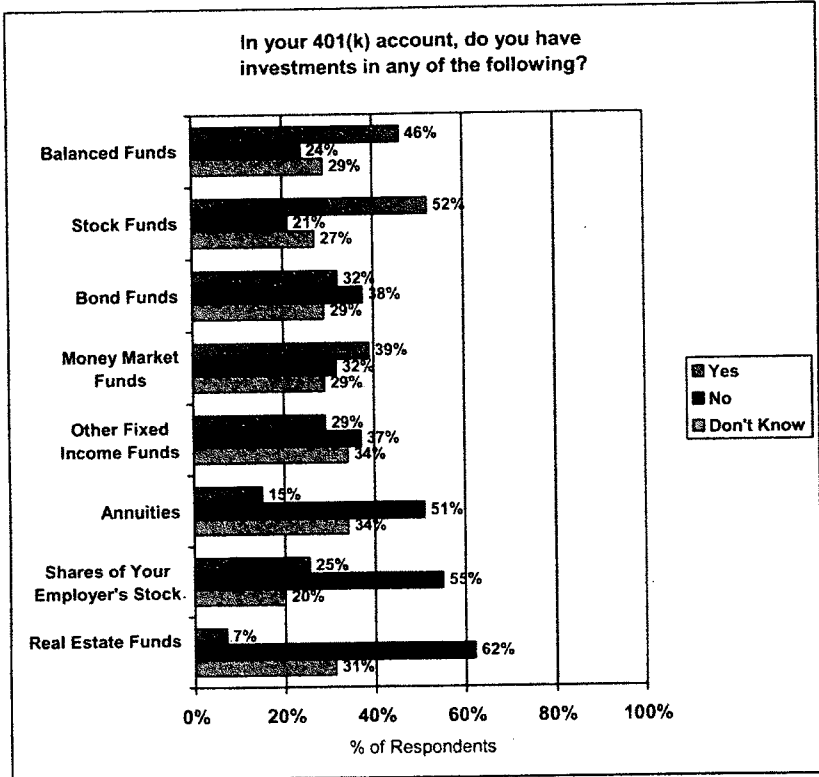
When rating the importance that they attach to five different aspects of investments—fees, risk, past performance, diversification, and reputation of provider, the majority of 401(k) plan participants who make decisions regarding their plans indicate that each of these aspects is "very" or "somewhat" important. Although participants are more likely to view the other four characteristics as important than they are to view fees as important, nearly eight in ten (79%) participants who make decisions about their investments rated fees as either "very" or "somewhat" important. In comparison, roughly nine in ten consider past performance (92%) and risk (91%) to be very or somewhat important, while nearly as many consider provider reputation (89%) and diversification (88%) to be important.

Those who view fees as important are most likely to cite summary information (48%) when asked where they turn for information about fees, followed by prospectuses (35%), employer-provided financial advisors (23%), personal financial advisors (17%), and the Internet (19%).

## How Well Do Participants Understand Their Plans and Associated Fees?

### Familiarity with Their Investments

The majority of 401(k) plan participants expressed a lack of basic knowledge about the investments in their 401(k) plans. Specifically, more than six in ten (65%) indicated that they do not know the names of all of the investments in which they have money saved through their plan. A sizeable portion of respondents also expressed uncertainty about the types of investments in their plans. For example, when asked to indicate whether their investments include certain types of funds, more than one in four (27%) did not know whether their plan includes a stock fund and approximately as many (29%) did not know whether their plan includes a bond fund.



Base: All 1,584 respondents. Chart does not display the small percentage (1% or less) of respondents who refused to answer each part of this question.

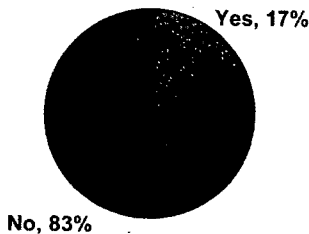
**Knowledge of Fees**

When asked whether they pay any fees for their 401(k) plan, nearly two in three (65%) 401(k) plan participants surveyed reported that they pay no fees and only about one in six (17%) stated that they do pay fees. Another 18 percent admitted that they do not know whether or not they pay any fees.

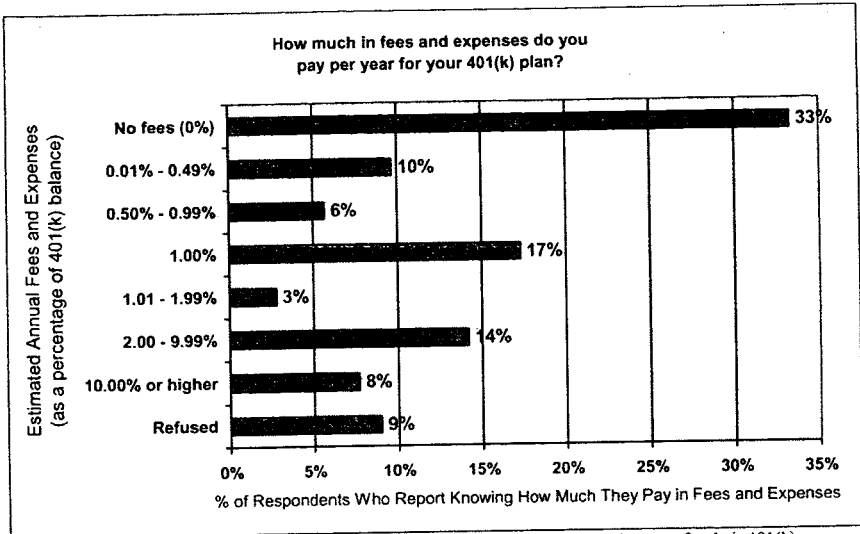
Nevertheless, after being told that 401(k) plan providers often charge fees for administering their plans and that these fees may be paid by either the employer that sponsors the plan or the employees that participate in the plan, the vast majority (83%) of respondents acknowledged that they do not know how much they pay in fees.

Only about one in six (17%) 401(k) participants reported that they know how much they pay in fees and expenses for their plan. When these respondents who reported knowing how much they pay in fees were asked to estimate the percentage of their account balance that is used to pay fees, approximately one in three (33%) indicated that they pay no fees, almost one in four (23%) reported that they pay fees equivalent to 1 percent or less of their account balance, and just over one in five (22%) estimated that their fees are 2 percent or more of their account balance. Another nine percent did not provide an estimate.

**Do you know how much in fees and expenses  
you are paying for your 401(k) plan?**



Base: All 1,584 respondents.



Base: Respondents who reported that they know how much in fees and expenses they pay for their 401(k) plan. (Unweighted N=317)

When asked whether their 401(k) plan charges specific types of fees, including an administrative fee and a redemption fee, more than half of respondents indicated that they do not know whether their plan charges such fees. Specifically, when asked whether their 401(k) plan charges an administrative fee, only about one in four (24%) said "yes," 21 percent said "no," and 55 percent replied that they did not know. When asked about redemption fees, fewer than one in ten (7%) survey respondents said they are charged a redemption fee, more than one in four (27%) replied that they are not charged such a fee, and nearly two in three (65%) did not know.

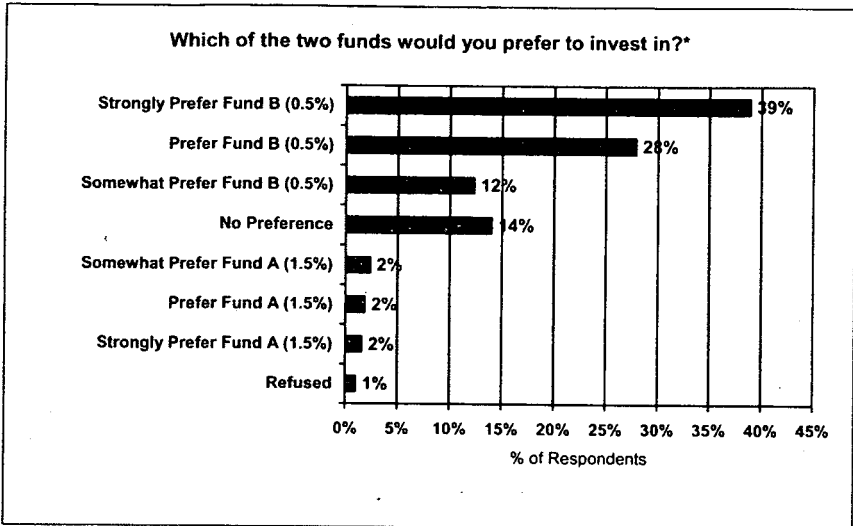
When asked to select the correct definitions of these two common types of fees as well as the correct definition of "expense ratio," just over half (51%) of respondents identified the correct definition of an administrative fee. However, fewer than four in ten (38%) respondents were able to identify the correct definition of "redemption fee," and fewer than two in ten (14%) were able to correctly define "expense ratio."

#### **Understanding the Effect of Fees**

More than half (54%) of survey respondents report that they do not feel knowledgeable about the effect that fees can have on their total retirement savings in the long term.

This lack of understanding of the long-term effect of fees is further supported by responses to an exercise in which 401(k) participants were asked to choose between two funds that were described as identical except for the fact that one fund had an expense ratio of 0.5% and the other

had an expense ratio of 1.5%. Remarkably, one in five (20%) respondents either expressed no preference for one fund over the other (14%) or expressed a preference for the fund with the higher expense ratio (6%). Encouragingly, however, the majority (79%) indicated a preference for the fund with the lower expense ratio.



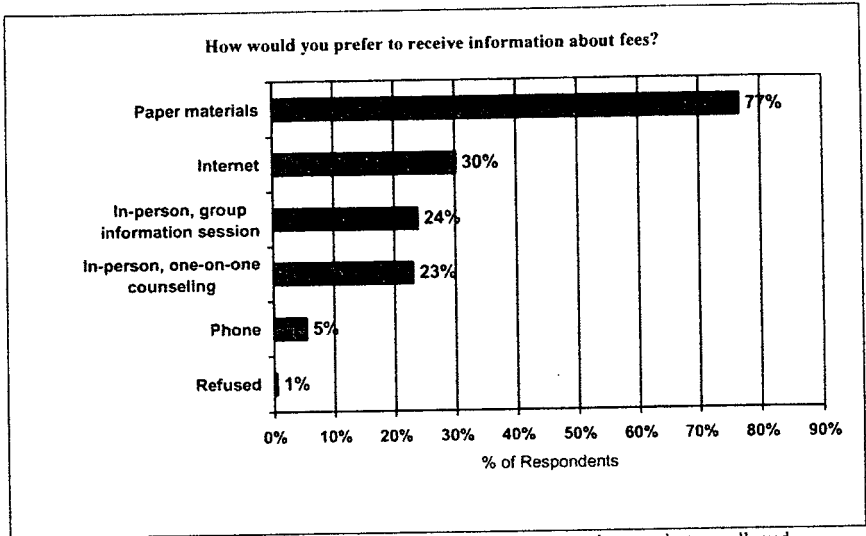
Base: All 1,584 respondents. \*Before selecting their preferred fund, respondents were presented with a table that displayed the expense ratios for two funds ("Fund A" and "Fund B") and noted that the difference between the two expense ratios was 1.0%. In order to reduce the potential effect of bias resulting from the order in which the funds were presented, half of the respondents were shown a table in which the fund with the 1.5% expense ratio was listed first and the other half were shown a table in which the fund with the 0.5% expense ratio was listed first. Respondents were instructed to assume that the funds were identical with the exception of the fees and expenses.

### How Would Participants Prefer to Receive Information about Fees?

The majority of respondents expressed an interest in receiving fee information before selecting their investments (61%) as well as on a regular basis (61%) after making their initial investment decisions. Slightly more than one third (36%) would like to receive fee information whenever fees change.

Paper materials (77%) are the most widely desired vehicle for receiving fee-related information. While paper materials were by far the most-preferred medium, respondents expressed interest in receiving information about fees from other media as well. Specifically, three in ten (30%) respondents would like to receive information about fees via the Internet, one in four (24%) expressed an interest in receiving this information through in-person group sessions, and nearly as many (23%) would like to learn about plan fees during in-person one-on-one counseling.





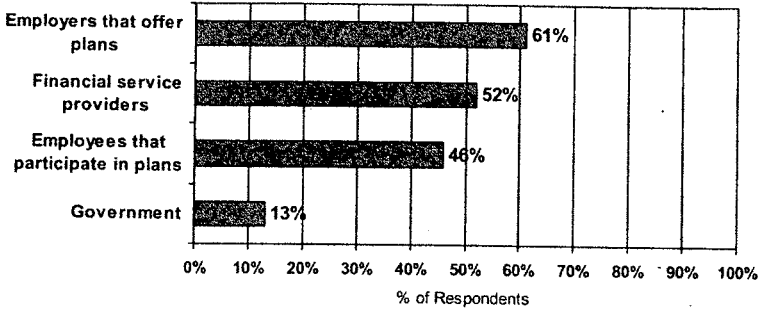
Base: All 1,584 respondents. Percentages add to more than 100% because each respondent was allowed to select multiple responses.

#### **Who should be responsible for ensuring that plan participants understand fees?**

The majority of 401(k) plan participants feel that employers that sponsor plans (61%) and financial service companies that administer the plans (52%) should be responsible for ensuring that participants understand the fees charged by their plans. Slightly fewer (46%) feel that employees themselves should be responsible, and just over one in ten (13%) feel that responsibility lies with the government.

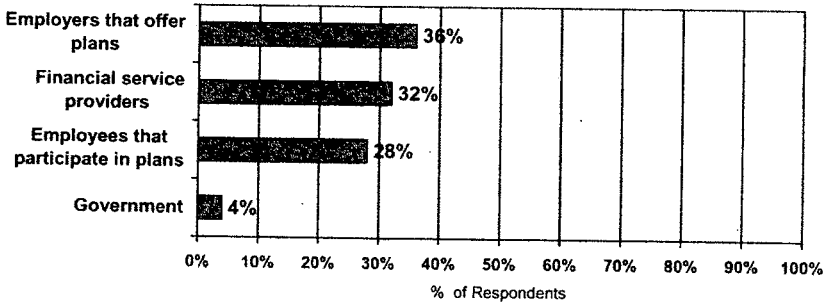
When asked who should be *most* responsible for ensuring that participants understand fees charged by plans, respondents are most likely to identify employers that sponsor plans (36%) followed by the financial services companies that administer the plans (32%) and employees that participate in plans (28%).

Who do you think should be responsible for ensuring that people, such as yourself, who participate in 401(k) plans have a clear understanding of the fees charged by 401(k) plans?



Base: All 1,584 respondents. Percentages add to more than 100% because each respondent was allowed to select multiple responses.

Who do you think should be most responsible for ensuring that people, such as yourself, who participate in 401(k) plans have a clear understanding of the fees charged by 401(k) plans?



Base: All 1,584 respondents.

**APPENDIX: ANNOTATED QUESTIONNAIRE**

Field period: June 8 – June 24, 2007

N interviews (unweighted): 1584

N interviews (weighted): 1584

For each survey question, this annotated questionnaire shows the responses of all respondents, respondents ages 25-49, and respondents ages 50+. The responses are displayed as percentages and reflect the percentage of respondents who qualified for each survey question. The percentages have been weighted as described in the Background and Methodology section of this report.

Unless otherwise noted, for each survey question, the base for all qualified respondents is 1584, the base for qualified respondents ages 25-49 is 758, and the base for qualified respondents ages 50+ is 826. The bases shown reflect the actual (unweighted) number of respondents who qualified for each question.

**KEY DEMOGRAPHICS****Age Split**

		Total
1.	25 to 49 years	62.4%
2.	50 years and over	37.6%

**Gender**

		Total
1.	Male	53.1%
2.	Female	46.9%

**Household income**

		Total
1.	Less than \$25K	10.4%
2.	\$25 to \$49.9K	29.0%
3.	\$50 to \$74.9K	26.3%
4.	\$75K or more	34.2%

**Education level**

		Total
1.	Less than High School	5.4%
2.	High School	23.7%
3.	Some college	27.2%
4.	4 year college degree or post-graduate	43.7%

**Race/Ethnicity**

		Total
1.	White, Non-Hispanic	70.7%
2.	Black/African-American, Non-Hispanic	10.2%
3.	Other, Non-Hispanic	8.2%
4.	Hispanic	10.1%
5.	2+ Races, Non-Hispanic	0.8%

SCR2. Do you currently have money saved for retirement in a ....

**401(k) plan**

		Age 25 - 49	Age 50 and over	Total
1.	Yes	100.0%	100.0%	100.0%
2.	No {TERMINATED}	0%	0%	0%
3.	Don't Know {TERMINATED}	0%	0%	0%

**Individual Retirement Account (IRA)**

		Age 25 - 49	Age 50 and over	Total
1.	Yes	39.3%	55.3%	45.3%
2.	No	57.9%	42.3%	52.0%
3.	Don't Know	2.2%	1.1%	1.8%
4.	Refused	0.6%	1.4%	0.9%

**Other type of retirement plan**

		Age 25 - 49	Age 50 and over	Total
1.	Yes	23.9%	43.3%	31.2%
2.	No	69.5%	48.6%	61.6%
3.	Don't Know	5.9%	5.5%	5.7%
4.	Refused	0.6%	2.7%	1.4%

SCR2a. In how many different 401(k) plans do you currently have money saved for retirement?

		Age 25 - 49	Age 50 and over	Total
1.	One	80.9%	75.1%	78.7%
2.	More than one	19.1%	24.9%	21.3%

{TERMINATED RESPONDENTS WHO SELECTED "DON'T KNOW" IN SCR2A OR WHO REFUSED TO ANSWER SCR2A.}

{BASE: ONLY ONE 401(K) PLAN IN SCR2A}

SCR2b. Thinking about the 401(k) plan in which you currently have money saved, is this 401(k) plan provided by...

	Age 25 - 49 (n=604)	Age 50 - 64 (n=629)	Total (n=1233)
1. Your current employer?	85.6%	68.7%	79.5%
2. Your former employer?	14.4%	31.0%	20.4%
3. Your spouse's current or former employer?	0.0%	0.0%	0.0%
4. Other	0.0%	0.0%	0.0%
5. Refused	0.0%	0.3%	0.1%

{TERMINATED RESPONDENTS WHO SELECTED "SPOUSE'S CURRENT OR FORMER EMPLOYER" OR "OTHER" IN SCR2B.}

{BASE: MORE THAN ONE 401(K) PLAN IN SCR2A}

SCR2c. Thinking about the 401(k) plans in which you currently have money saved, are any of these 401(k) plans provided by..

	Age 25 - 49 (n=154)	Age 50 - 64 (n=197)	Total (n=351)
1. Your current employer?	87.6%	73.2%	81.3%
2. Your former employer?	64.0%	72.2%	67.6%
3. Your spouse's current or former employer?	32.4%	26.7%	29.9%
4. Other (Net)	2.2%	3.2%	2.6%
5. Refused	0.0%	0.0%	0.0%

{TERMINATED RESPONDENTS WHO DID NOT SELECT "CURRENT EMPLOYER" AND/OR "FORMER EMPLOYER" IN SCR2C.}

## SCR3. Which of the following best describes your current employment status?

		Age 25-49	Age 50 and over	Total
1.	Employed full-time (not yet retired)	90.4%	64.7%	80.7%
2.	Employed part-time (not yet retired)	4.4%	5.7%	4.9%
3.	Unemployed and looking for work (not yet retired)	1.0%	1.8%	1.3%
4.	Retired and not working	0.0%	17.6%	6.6%
5.	Retired, but still employed full-time	0.5%	2.6%	1.3%
6.	Retired, but still employed part-time	0.0%	4.4%	1.6%
7.	Full-time student (not employed and not yet retired)	0.8%	0.1%	0.5%
8.	Homemaker (not employed and not looking for work)	1.5%	0.8%	1.2%
9.	Disabled (not employed and not looking for work)	0.8%	2.2%	1.3%
10.	Other (Net)	0.6%	0.2%	0.5%

{BASE: EMPLOYED OR "OTHER" IN SCR3}

SCR3a. Are you currently self-employed? (If you have more than one job, please indicate if you are self-employed in your main job.)

		Age 25-49 (n=721)	Age 50- (n=922)	Total (n=1,643)
1.	Yes	3.8%	6.4%	4.7%
2.	No	96.1%	93.5%	95.3%
3.	Refused	0.1%	0.1%	0.1%

For the rest of this survey, the term "401(k) plan" refers to the 401(k) plan(s) provided by your current or former employer. Please do not refer to other 401(k) plans, such as any 401(k) plans provided by your spouse's employer.

SCR4. Within the past 12 months, have you ...

... Contributed money to your 401(k) plan?

		Age 25-49	Age 50 and over	Total
1.	Yes	84.6%	71.0%	79.5%
2.	No	14.1%	27.4%	19.1%
3.	Don't know	1.2%	0.8%	1.0%
4.	Refused	0.1%	0.8%	0.4%

... Reviewed the performance of your 401(k) plan?

		Age 25-49	Age 50 and over	Total
1.	Yes	77.4%	82.1%	79.2%
2.	No	21.4%	15.2%	19.1%
3.	Don't know	0.4%	1.0%	0.6%
4.	Refused	0.8%	1.8%	1.1%

... Made changes to the investments in your 401(k) plan?

		Age 25-49	Age 50 and over	Total
1.	Yes	31.4%	30.0%	30.9%
2.	No	67.8%	66.8%	67.4%
3.	Don't know	0.2%	1.3%	0.6%
4.	Refused	0.7%	2.0%	1.2%

... Withdrawn money, or received payments, from your 401(k) plan?

		Age 25-49	Age 50 and over	Total
1.	Yes	7.1%	14.5%	9.9%
2.	No	91.8%	83.6%	88.7%
3.	Don't know	0.1%	0.4%	0.2%
4.	Refused	0.9%	1.5%	1.2%

Please take some time and answer the following questions. This is not a test. We simply want to know about your experience with your **401(k) plan**.

Unless otherwise noted, if you currently have money saved in more than one 401(k) plan, please refer to the 401(k) plan that **you yourself** joined most recently through your current or former employer when answering the rest of the questions. Do **not** refer to a 401(k) plan provided by your spouse's employer.



DM0.5. Do you pay any fees for your 401(k) plan?

		Age 25-49	Age 50 and above	Total
1.	Yes	13.6%	23.4%	17.3%
2.	No	67.1%	61.2%	64.9%
3.	Don't know	19.4%	15.4%	17.9%

**DECISION-MAKING PROCESS**

DM1. Which of the following best describes how you make decisions about the investments for your 401(k) plan?

		Age 25-49	Age 50 and above	Total
1.	I make all investment decisions entirely <u>on my own without</u> seeking advice from other people	39.3%	35.6%	37.9%
2.	I make my own investment decisions, but I seek advice from other people before I make decisions	32.2%	28.6%	30.8%
3.	I am involved in making the investment decisions, but I rely on other people to help me make the decisions	16.3%	21.2%	18.1%
4.	I am <u>not at all</u> involved in making the investment decisions; I <u>rely entirely on other people</u> to make the decisions for me	12.3%	14.6%	13.2%

DM1a. Which of the following best describes your marital status?

		Age 25-49	Age 50 and above	Total
1.	Married	58.7%	61.1%	59.6%
2.	Separated	1.7%	1.4%	1.6%
3.	Divorced	8.1%	20.1%	12.6%
4.	Widowed	0.2%	4.9%	1.9%
5.	Single, never married	30.9%	12.4%	23.9%
6.	Refused	0.3%	0.2%	0.3%

{ BASE: ALL RESPONDENTS EXCEPT THOSE WHO SELECTED "ENTIRELY ON OWN"/OPTION 1 IN DM1}  
 DM2. Which, if any, of the following individuals do you consult for information or advice when making decisions about the investments for your 401(k) plan?

		Yes (n=133)	No (n=59)	Ref (n=10)
1.	Personal financial advisor ( <u>not</u> through your employer)	24.6%	37.8%	29.8%
2.	Financial advisor provided through your employer	29.9%	30.8%	30.3%
3.	Personal accountant or CPA	7.4%	13.8%	9.9%
4.	Banker	3.5%	5.1%	4.1%
5.	Insurance agent	2.0%	2.7%	2.3%
6.	Lawyer	1.0%	0.6%	0.9%
7.	Spouse	29.9%	29.1%	29.6%
8.	Family member (other than spouse)	31.0%	15.7%	25.0%
9.	Friend	22.4%	19.0%	21.1%
10.	Colleague	18.2%	11.2%	15.5%
11.	Other (Net)	0.2%	0.5%	0.3%
12.	None / nothing*	0.3%	1.6%	0.8%
13.	Don't Know*	0.2%	0.0%	0.1%
14.	Refused	2.8%	2.5%	2.7%

\* "None"/"Nothing" and "Don't Know" were written in by some respondents but were not listed as response options.

{ BASE: ALL RESPONDENTS EXCEPT THOSE WHO SELECTED "ENTIRELY ON OWN"/OPTION 1 IN DM1 AND EXCLUDING THOSE WHO SELECTED "FINANCIAL ADVISOR PROVIDED THROUGH YOUR EMPLOYER" IN DM2}

DM3. Does the employer that provides your 401(k) plan offer you the ability to...

... Talk to a financial advisor about your 401(k) plan?

		Yes (n=11)	No (n=22)	Ref (n=17)
1.	Yes	52.1%	49.9%	51.3%
2.	No	23.7%	25.8%	24.5%
3.	Don't know	23.9%	22.3%	23.3%
4.	Refused	0.3%	2.0%	0.9%

... Access a financial advice service over the Internet for advice about your 401(k) plan?

		Age 25 - 49 (n=612)	Age 50+ (n=852)	Total (n=1464)
1.	Yes	55.3%	45.0%	51.5%
2.	No	18.9%	25.1%	21.2%
3.	Don't know	25.1%	26.9%	25.8%
4.	Refused	0.7%	2.9%	1.5%

{BASE: ALL RESPONDENTS EXCEPT THOSE WHO SELECTED "RELY ENTIRELY ON OTHER PEOPLE"/OPTION 4 IN DM1}

DM4. Which, if any, of the following materials or resources do you consult for information or advice when making decisions about the investments for your 401(k) plan?

		Age 25 - 49 (n=664)	Age 50+ (n=899)	Total (n=1563)
1.	Prospectuses for the mutual funds or the other investment choices	33.5%	33.6%	33.5%
2.	Summary information about the mutual funds or the other investment choices	56.0%	57.6%	56.6%
3.	Internet	38.4%	27.3%	34.3%
4.	Financial magazine articles	14.4%	20.4%	16.6%
5.	Books about investing	8.3%	8.8%	8.5%
6.	Financial shows on TV	11.9%	18.4%	14.3%
7.	Research analyst's recommendations	21.9%	22.8%	22.3%
8.	Other (Net)	0.9%	3.4%	1.8%
9.	None / nothing*	3.2%	3.2%	3.2%
10.	Don't Know*	0.2%	0.3%	0.2%
11.	Refused	8.5%	7.0%	8.0%

\* "None"/"Nothing" and "Don't Know" were written in by some respondents but were not listed as response options.

{BASE: RESPONDENTS WHO SELECTED "INTERNET" IN DM4}

DM5. You indicated that you consult the Internet for information or advice when making decisions about the investments for your 401(k) plan. Please select all of the types of Internet sites that you use for this purpose.

	Age 25-49 (n=256)	Age 50-59 (n=195)	Total (n=451)
1. Web site of the company that manages your 401(k) plan	74.7%	69.8%	73.2%
2. News and information web sites**	53.8%	66.9%	57.7%
3. Stock or fund trading web sites**	40.2%	32.4%	37.9%
4. Other (Net)	1.0%	2.5%	1.5%
5. Don't Know*	1.8%	1.8%	1.8%
6. Refused	0.0%	0.4%	0.1%

\*"Don't Know" was written in by some respondents but was not listed as a response option.

\*\* Examples of news and information web sites and stock/fund trading sites were listed.

{BASE: ALL RESPONDENTS EXCEPT THOSE WHO SELECTED "RELY ENTIRELY ON OTHER PEOPLE"/OPTION 4 IN DM1}

DM6. How important is each of the following factors to you when making decisions about the investments for your 401(k) plan?

Fees charged for the investments (administrative fees, transaction fees, or other fees)

	Age 25-49 (n=256)	Age 50-59 (n=195)	Total (n=451)
1. Very Important	47.9%	45.0%	46.8%
2. Somewhat Important	30.8%	34.5%	32.2%
3. Not too Important	13.7%	10.7%	12.6%
4. Not at all Important	2.0%	4.4%	2.9%
5. Don't know	5.6%	5.3%	5.5%
6. Refused	0.0%	0.1%	0.1%

Risk of the investments

	Age 25-49 (n=256)	Age 50-59 (n=195)	Total (n=451)
1. Very Important	53.7%	65.5%	58.1%
2. Somewhat Important	34.3%	29.3%	32.4%
3. Not too Important	7.4%	2.9%	5.7%
4. Not at all Important	1.2%	0.4%	0.9%
5. Don't know	3.4%	1.5%	2.7%
6. Refused	0.0%	0.4%	0.2%

Past performance of the investments (how much the investments have changed in value over the past several years, compared to other investments)

		Age 25-49 (n=66)	Age 50-64 (n=69)	Total (n=135)
1.	Very Important	55.2%	61.5%	57.5%
2.	Somewhat Important	35.3%	33.7%	34.7%
3.	Not too Important	5.7%	2.9%	4.7%
4.	Not at all Important	0.2%	0.4%	0.3%
5.	Don't know	3.5%	1.4%	2.7%
6.	Refused	0.0%	0.1%	0.1%

Diversification of the investments (whether your investments include a mix of different types of investments)

		Age 25-49 (n=66)	Age 50-64 (n=69)	Total (n=135)
1.	Very Important	51.4%	54.3%	52.5%
2.	Somewhat Important	35.5%	34.2%	35.0%
3.	Not too Important	8.0%	6.6%	7.5%
4.	Not at all Important	0.9%	2.0%	1.3%
5.	Don't know	4.1%	2.7%	3.6%
6.	Refused	0.0%	0.1%	0.1%

Reputation of the financial services company that manages the investments

		Age 25-49 (n=66)	Age 50-64 (n=69)	Total (n=135)
1.	Very Important	49.8%	63.6%	54.9%
2.	Somewhat Important	37.2%	27.6%	33.6%
3.	Not too Important	8.7%	4.8%	7.3%
4.	Not at all Important	0.4%	1.5%	0.8%
5.	Don't know	3.8%	2.4%	3.3%
6.	Refused	0.0%	0.1%	0.1%

{BASE: FEES ARE "VERY" OR "SOMEWHAT" IMPORTANT IN DM6}

DM7. You indicated that fees are important to you when making decisions about the investments for your 401(k) plan. Where do you get information about fees?

**Prospectuses for the mutual funds or the other investment choices**

		Age 25 - 49 (n=521)	Age 50+ (n=552)	Total (n=1073)
1.	Yes	33.5%	36.3%	34.5%
2.	No	66.5%	63.7%	65.5%

**Summary information about the mutual funds or the other investment choices**

		Age 25 - 49 (n=521)	Age 50+ (n=552)	Total (n=1073)
1.	Yes	48.6%	46.2%	47.7%
2.	No	51.4%	53.8%	52.3%

**Internet**

		Age 25 - 49 (n=521)	Age 50+ (n=552)	Total (n=1073)
1.	Yes	21.6%	14.0%	18.8%
2.	No	78.4%	86.0%	82.2%

**Financial magazine articles**

		Age 25 - 49 (n=521)	Age 50+ (n=552)	Total (n=1073)
1.	Yes	2.7%	8.4%	4.8%
2.	No	97.3%	91.6%	95.2%

**Books about investing**

		Age 25 - 49 (n=521)	Age 50+ (n=552)	Total (n=1073)
1.	Yes	2.7%	4.6%	3.4%
2.	No	97.3%	95.4%	96.6%

**Financial shows on TV**

		Age 25 - 49 (n=521)	Age 50+ (n=552)	Total (n=1073)
1.	Yes	1.8%	7.6%	4.0%
2.	No	98.2%	92.4%	96.0%

**Research analyst**

		Age 15-49 (n=541)	Age 50-64 (n=532)	Age 65-74 (n=153)
1.	<b>Yes</b>	1.2%	3.9%	2.2%
2.	<b>No</b>	98.8%	96.1%	97.8%

**Personal financial advisor (not through your employer)**

		Age 15-49 (n=541)	Age 50-64 (n=532)	Age 65-74 (n=153)
1.	<b>Yes</b>	12.7%	23.9%	16.8%
2.	<b>No</b>	87.3%	76.1%	83.2%

**Financial advisor provided through your employer**

		Age 15-49 (n=541)	Age 50-64 (n=532)	Age 65-74 (n=153)
1.	<b>Yes</b>	24.6%	20.3%	23.0%
2.	<b>No</b>	75.4%	79.7%	77.0%

**Other (Net)**

		Age 15-49 (n=541)	Age 50-64 (n=532)	Age 65-74 (n=153)
1.	<b>Yes</b>	2.0%	3.1%	2.4%
2.	<b>No</b>	98.0%	96.9%	97.6%

**Don't Know\***

		Age 15-49 (n=541)	Age 50-64 (n=532)	Age 65-74 (n=153)
	<b>Yes</b>	1.5%	0.9%	1.3%

**None/Nothing\***

		Age 15-49 (n=541)	Age 50-64 (n=532)	Age 65-74 (n=153)
	<b>Yes</b>	0.6%	0.1%	0.4%

**Refused**

		Age 15-49 (n=541)	Age 50-64 (n=532)	Age 65-74 (n=153)
	<b>Yes</b>	1.9%	1.5%	1.8%

\*"None"/"Nothing" and "Don't Know" were written in by some respondents but were not listed as response options.

**EXPECTED DEGREE OF RELIANCE ON 401(K) PLAN**

**ED1. Do you expect that your 401(k) plan will be a major or minor source of your income in your retirement?**

(In this question, "your 401(k) plan" refers to any 401(k) plans provided by your current or former employer in which you currently have money saved. If you currently have money saved in more than one 401(k) plan, please consider all of your 401(k) plans when answering this question. "Your 401(k) plan" does not refer to any 401(k) plans provided by your spouse's employer, and it does not refer to savings in other types of retirement accounts.)

(In this question, "your 401(k) plan" refers to the 401(k) plan provided by your current or former employer in which you currently have money saved. "Your 401(k) plan" does not refer to any 401(k) plans provided by your spouse's employer, and it does not refer to savings in other types of retirement accounts.)

		Age 25-30	Age 30 and over	Total
1.	<b>Major source</b>	57.0%	43.3%	51.9%
2.	<b>Minor source</b>	27.7%	46.1%	34.6%
3.	<b>Don't know</b>	14.9%	10.6%	13.3%
4.	<b>Refused</b>	0.3%	0.0%	0.2%



**UNDERSTANDING OF INVESTMENTS AND FEES**

Reminder: For the rest of these questions, unless otherwise noted, if you currently have money saved in more than one 401(k) plan, please refer to the 401(k) plan that you yourself joined most recently. Do not refer to any 401(k) plans provided by your spouse's employer.

**UN1. Do you know the names of all of the funds or investments in which you have money saved through your 401(k) plan?**

		Age 25 - 49	Age 50 and over	Total
1.	<b>Yes</b>	29.9%	43.6%	35.0%
2.	<b>No</b>	70.1%	56.2%	64.9%
3.	<b>Refused</b>	0.0%	0.3%	0.1%

**UN2. In your 401(k) plan account, do you have investments in any of the following?**

**Balanced Funds (Funds that invest in a balanced mix of both stocks and bonds)**

		Age 25 - 49	Age 50 and over	Total
1.	<b>Yes</b>	43.6%	51.2%	46.4%
2.	<b>No</b>	22.4%	26.5%	23.9%
3.	<b>Don't Know</b>	32.7%	21.5%	28.5%
4.	<b>Refused</b>	1.3%	0.8%	1.1%

**Stock Funds (Funds that invest primarily in stocks)**

		Age 25 - 49	Age 50 and over	Total
1.	<b>Yes</b>	49.8%	56.0%	52.1%
2.	<b>No</b>	19.6%	22.6%	20.7%
3.	<b>Don't Know</b>	30.1%	21.0%	26.7%
4.	<b>Refused</b>	0.5%	0.4%	0.5%

**Bond Funds (Funds that invest primarily in bonds)**

		Age 25-49	Age 50 and over	Total
1.	Yes	31.4%	33.6%	32.3%
2.	No	36.4%	40.2%	37.8%
3.	Don't Know	32.1%	25.0%	29.4%
4.	Refused	0.1%	1.1%	0.5%

**Money Market Funds**

		Age 25-49	Age 50 and over	Total
1.	Yes	36.5%	42.3%	38.7%
2.	No	30.8%	33.8%	31.9%
3.	Don't Know	32.7%	22.7%	28.9%
4.	Refused	0.0%	1.2%	0.5%

**Other Fixed Income funds (Funds such as Guaranteed Investment Contracts, stable value funds, or other funds that provide low but steady returns and are often used for income)**

		Age 25-49	Age 50 and over	Total
1.	Yes	24.6%	36.5%	29.1%
2.	No	38.1%	34.3%	36.7%
3.	Don't Know	36.9%	27.8%	33.5%
4.	Refused	0.3%	1.4%	0.7%

**Annuities (Funds that, after receiving your contributions and after reaching a certain date, guarantee to make regular payments to you for a certain period of time or for the rest of your life.)**

		Age 25-49	Age 50 and over	Total
1.	Yes	13.7%	17.1%	15.0%
2.	No	48.6%	54.2%	50.7%
3.	Don't Know	37.4%	27.2%	33.6%
4.	Refused	0.3%	1.4%	0.7%

## Shares of your employer's stock

		Age 25 - 49	Age 50 and over	Total
1.	Yes	27.5%	21.2%	25.1%
2.	No	50.4%	61.6%	54.6%
3.	Don't Know	21.9%	15.8%	19.6%
4.	Refused	0.3%	1.5%	0.7%

Real Estate funds, sometimes called  
Real Estate Investment Trusts (REITs)

		Age 25 - 49	Age 50 and over	Total
1.	Yes	6.7%	6.3%	6.6%
2.	No	59.4%	65.5%	61.7%
3.	Don't Know	33.5%	26.8%	31.0%
4.	Refused	0.3%	1.4%	0.7%

## Other

		Age 25 - 49	Age 50 and over	Total
1.	Yes	6.0%	6.5%	6.2%
2.	No	43.7%	48.5%	45.5%
3.	Don't Know	49.2%	41.3%	46.2%
4.	Refused	1.0%	3.7%	2.0%

UN2a. You told us that your 401(k) plan account includes investments other than those listed in the previous question. What other types of investments are in your 401(k) plan account?

{BASE: "YES" FOR ANY ITEM IN UN2}

UN3. Are any of the funds in your 401(k) plan account a Life Cycle Fund or Target Retirement Date Fund? (A Life Cycle Fund or Target Retirement Date Fund is a fund in which the mix of investments automatically changes based on how far away you are from retirement. As you approach your expected date of retirement, the mix of investments changes from riskier investments with greater chances of high returns to more conservative investments with lower returns but less risk.)

		Age 25 - 49	Age 50 and over	Total
1.	Yes	14.7%	10.9%	13.2%
2.	No	60.8%	67.7%	63.5%
3.	Don't Know	24.5%	21.4%	23.3%

- UN4. Financial services companies that manage 401(k) plans charge fees for administering and managing those plans. The fees are paid by the employer that provides the plan and/or the employees that participate in the plan. Often, the 401(k) plan management company simply deducts the fees from each participant's 401(k) plan balance, so you rarely receive a bill for the fees.

Do you know how much in fees and expenses you are paying for your 401(k) plan?

		Age 25-49	Age 50 and over	Total
1.	Yes	14.7%	20.8%	17.0%
2.	No	85.3%	79.0%	82.9%
3.	Refused	0.0%	0.2%	0.1%

{BASE: "YES" IN UN4}

- UN5. How much in fees and expenses do you pay per year for your 401(k) plan? Please answer as a percentage of your total 401(k) account balance. (If your 401(k) account balance is invested in more than one fund or investment, please estimate the average percentage of your total 401(k) account balance that is used to pay fees and expenses for all of your 401(k) investments.)

		Age 25-49 (n=124)	Age 50+ (n=193)	Total (n=317)
1.	0	38.0%	27.9%	33.3%
2.	Above 0 to 0.49%	5.7%	14.4%	9.7%
3.	0.50 to 0.99%	7.7%	3.5%	5.7%
4.	1.00%	12.9%	22.5%	17.3%
5.	1.01 to 1.99%	3.3%	2.3%	2.8%
6.	2.00% or higher (net)	21.2%	22.9%	22.0%
	2.00 to 9.99%	12.3%	16.5%	14.2%
	10.00% or higher	8.9%	6.4%	7.7%
7.	Refused	11.3%	6.6%	9.1%

**UN6.** The questions below are designed to understand how familiar you are with different types of fees that may be charged for mutual funds and other types of investments in 401(k) plans.

Does your 401(k) plan charge you a...

**Administrative Fee**

	Yes	No	Don't Know	Refused
1. Yes	20.6%	29.2%	23.9%	
2. No	20.3%	22.3%	21.0%	
3. Don't Know	59.1%	48.3%	55.1%	
4. Refused	0.0%	0.2%	0.1%	

**Redemption Fee**

	Yes	No	Don't Know	Refused
1. Yes	7.2%	7.9%	7.4%	
2. No	24.0%	32.5%	27.2%	
3. Don't Know	68.8%	59.3%	65.2%	
4. Refused	0.0%	0.3%	0.1%	

**UN7.** Which of these statements is the correct definition of an administrative fee?

	Yes	No	Don't Know	Refused
1. A fee charged on a regular basis to cover the ongoing costs of administering your account {CORRECT}	47.1%	58.3%	51.3%	
2. A fee charged each time you contact the company that manages your 401(k) plan to cover the administrative costs of fulfilling your information requests	3.0%	1.8%	2.6%	
3. A one-time fee charged to cover the administrative costs of setting up your account	9.7%	8.5%	9.2%	
4. Don't know	39.8%	31.1%	36.5%	
5. Refused	0.5%	0.2%	0.4%	

UN8. Which of these statements is the correct definition of a redemption fee?

		Age 25-49	Age 50 and over	Total
1.	A fee charged when you move all of your money from certain mutual funds into other mutual funds. {CORRECT}	37.5%	39.9%	38.4%
2.	A fee charged if you contribute nothing to your 401(k) account for a certain number of months.	1.2%	1.2%	1.2%
3.	A fee charged on a regular basis to cover the costs of providing all 401(k) plan participants with updates about the performance of their accounts.	4.2%	6.0%	4.9%
4.	Don't know	57.1%	52.7%	55.4%
5.	Refused	0.0%	0.2%	0.1%

UN9. Which of these statements is the correct definition of an expense ratio?

		Age 25-49	Age 50 and over	Total
1.	The percentage of a mutual fund's total assets that is used to pay the fund's operating expenses. {CORRECT}	12.8%	15.1%	13.7%
2.	The percentage of a mutual fund's total earnings over a 12-month period that is used to pay the fund's total expenses.	13.8%	13.2%	13.6%
3.	The operating expenses for a certain mutual fund stated as a percentage of the total operating expenses for all mutual funds managed by the same company	12.5%	9.0%	11.2%
4.	Don't know	60.9%	62.6%	61.5%
5.	Refused	0.0%	0.2%	0.1%

UN10. How confident are you that you selected the correct definitions of the following fee-related terms in the previous questions?

**administrative fee**

	Very confident (n=15)	Somewhat confident (n=42)	Not too confident (n=38)	Not at all confident (n=2)
1. Very confident	25.4%	25.2%	25.3%	
2. Somewhat confident	47.5%	48.2%	47.8%	
3. Not too confident	22.3%	21.6%	22.0%	
4. Not at all confident	4.6%	4.7%	4.7%	
5. Refused	0.2%	0.3%	0.3%	

**redemption fee**

	Very confident (n=15)	Somewhat confident (n=42)	Not too confident (n=38)	Not at all confident (n=2)
1. Very confident	19.3%	21.9%	20.4%	
2. Somewhat confident	44.4%	42.1%	43.5%	
3. Not too confident	30.5%	29.3%	30.0%	
4. Not at all confident	5.5%	5.0%	5.3%	
5. Refused	0.2%	1.8%	0.8%	

**expense ratio**

	Very confident (n=15)	Somewhat confident (n=42)	Not too confident (n=38)	Not at all confident (n=2)
1. Very confident	13.3%	14.1%	13.6%	
2. Somewhat confident	44.6%	44.0%	44.4%	
3. Not too confident	36.5%	37.1%	36.7%	
4. Not at all confident	4.4%	2.7%	3.8%	
5. Refused	1.2%	2.1%	1.5%	

UN11. The table below shows the total annual operating expenses for two different mutual funds.

[SWITCH ORDER OF FUND A AND B COLUMNS SUCH THAT HALF SEE A WITH 1.5% AND HALF SEE A WITH 0.5%]

	Fund A	Fund B	Difference between Fund A and Fund B
<b>Total annual operating fees and expenses</b> (annual fees and expenses that are deducted from your account balance)	1.5%	0.5%	1.0%

Based on the information above about the fees and expenses of each fund, which of the two funds would you prefer to invest in? (Please assume that the funds are the same except for the fees and expenses.)

	Age 25-49	Age 50 and over	Total
1. <b>Strongly Prefer Fund A</b>	1.3%	2.1%	1.6%
2. <b>Prefer Fund A</b>	2.2%	1.4%	1.9%
3. <b>Somewhat Prefer Fund A</b>	3.2%	1.3%	2.4%
4. <b>No Preference</b>	15.1%	12.2%	14.0%
5. <b>Somewhat Prefer Fund B</b>	13.0%	11.2%	12.3%
6. <b>Prefer Fund B</b>	27.6%	28.3%	27.9%
7. <b>Strongly Prefer Fund B</b>	36.8%	42.2%	38.9%
8. <b>Refused</b>	0.9%	1.2%	1.0%

UN12. Please rate your agreement with each of the following statements:

Annual fees of 1.5% are not that much more than annual fees of 0.5%.

	Strongly Agree	Somewhat Agree	Somewhat Disagree	Strongly Disagree
1. <b>Strongly Agree</b>	2.1%	3.1%	2.5%	
2. <b>Somewhat Agree</b>	13.8%	12.2%	13.2%	
3. <b>Somewhat Disagree</b>	42.4%	33.2%	38.9%	
4. <b>Strongly Disagree</b>	40.2%	50.1%	43.9%	
5. <b>Refused</b>	1.5%	1.4%	1.5%	



The difference in annual fees between Fund A and Fund B (a difference of 1%) will not have a very big impact on my total long-term retirement savings.

		Age 25-40	Age 41 and older	Total
1.	<b>Strongly Agree</b>	2.7%	3.8%	3.1%
2.	<b>Somewhat Agree</b>	19.1%	16.7%	18.2%
3.	<b>Somewhat Disagree</b>	39.8%	36.5%	38.6%
4.	<b>Strongly Disagree</b>	37.1%	41.8%	38.9%
5.	<b>Refused</b>	1.4%	1.2%	1.3%

I have a good understanding of how fees can affect my retirement savings in the long term.

		Age 25-40	Age 41 and older	Total
1.	<b>Strongly Agree</b>	14.5%	15.1%	14.7%
2.	<b>Somewhat Agree</b>	39.0%	43.2%	40.6%
3.	<b>Somewhat Disagree</b>	34.9%	30.5%	33.3%
4.	<b>Strongly Disagree</b>	9.8%	9.7%	9.8%
5.	<b>Refused</b>	1.8%	1.5%	1.7%

I wish that I had a better understanding of the effect that fees can have on my long-term retirement savings.

		Age 25-40	Age 41 and older	Total
1.	<b>Strongly Agree</b>	28.3%	29.6%	28.8%
2.	<b>Somewhat Agree</b>	45.7%	44.5%	45.3%
3.	<b>Somewhat Disagree</b>	21.0%	19.0%	20.3%
4.	<b>Strongly Disagree</b>	3.6%	5.7%	4.4%
5.	<b>Refused</b>	1.4%	1.2%	1.3%

I feel confident in my ability to select investments for my 401(k) plan that are best for my needs.

		Age 25-40	Age 41 and older	Total
1.	<b>Strongly Agree</b>	12.0%	11.9%	11.9%
2.	<b>Somewhat Agree</b>	46.9%	49.5%	47.9%
3.	<b>Somewhat Disagree</b>	33.1%	27.5%	31.0%
4.	<b>Strongly Disagree</b>	6.7%	10.0%	7.9%
5.	<b>Refused</b>	1.4%	1.1%	1.3%

I do not have confidence in my ability to make good decisions about investments for my 401(k) plan.

		Age 25 - 49	Age 50 and over	Total
1.	<b>Strongly Agree</b>	10.0%	10.2%	10.1%
2.	<b>Somewhat Agree</b>	34.2%	30.8%	32.9%
3.	<b>Somewhat Disagree</b>	40.7%	40.1%	40.4%
4.	<b>Strongly Disagree</b>	13.9%	17.0%	15.1%
5.	<b>Refused</b>	1.2%	1.9%	1.5%

UN13. How knowledgeable do you feel about the impact that fees can have on your total retirement savings?

		Age 25 - 49	Age 50 and over	Total
1.	<b>Very knowledgeable</b>	7.3%	9.3%	8.0%
2.	<b>Somewhat knowledgeable</b>	36.6%	38.8%	37.4%
3.	<b>Not too knowledgeable</b>	41.2%	35.9%	39.2%
4.	<b>Not at all knowledgeable</b>	14.7%	16.0%	15.2%
5.	<b>Refused</b>	0.2%	0.0%	0.2%

#### PREFERENCES FOR RECEIVING INFORMATION ABOUT FEES

PR1. Who do you think should be responsible for ensuring that people, such as yourself, who participate in 401(k) plans have a clear understanding of the fees charged by 401(k) plans? (Select one or more.)

		Age 25 - 49	Age 50 and over	Total
1.	<b>Employers that offer 401(k) plans to their employees</b>	62.4%	57.2%	60.5%
2.	<b>Government</b>	13.3%	12.9%	13.1%
3.	<b>Financial services companies that manage 401(k) plans</b>	51.8%	53.2%	52.3%
4.	<b>Employees, such as yourself, that participate in 401(k) plans</b>	47.2%	44.8%	46.3%
5.	<b>Refused</b>	0.3%	0.2%	0.2%

**PR1b.** Who do you think should be most responsible for ensuring that people, such as yourself, who participate in 401(k) plans have a clear understanding of the fees charged by 401(k) plans? (Select one.)

		Age 25 - 49	Age 50 and over	Total
1.	Employers that offer 401(k) plans to their employees	36.8%	35.1%	36.1%
2.	Government	4.1%	3.5%	3.9%
3.	Financial services companies that manage 401(k) plans	30.7%	33.0%	31.5%
4.	Employees, such as yourself, that participate in 401(k) plans	28.2%	28.1%	28.2%
5.	Refused	0.3%	0.2%	0.2%

**PR2.** When would you prefer to receive information about the fees charged for investments in your 401(k) plan?

		Age 25 - 49	Age 50 and over	Total
1.	Before you choose the funds or investments	62.3%	58.8%	61.0%
2.	On a regular basis (such as quarterly or once a year) regardless of whether fees change or stay the same	61.0%	59.8%	60.5%
3.	Whenever the fees change	37.2%	33.6%	35.8%
4.	Refused	1.8%	0.5%	1.3%

**PR3.** How would you prefer to receive information about fees?

		Age 25 - 49	Age 50 and over	Total
1.	Over the phone	5.4%	5.3%	5.4%
2.	Paper materials / in written form	75.8%	78.1%	76.7%
3.	On the Internet	35.3%	21.8%	30.2%
4.	In-person, group information session	25.8%	20.8%	23.9%
5.	In-person, one-on-one counseling	22.2%	24.5%	23.1%
6.	Refused	0.3%	0.8%	0.5%

**CLASSIFICATION QUESTIONS**

**CL1.** In total, including money that you have contributed as well as any contributions from your employer and returns from your investments, what is the total amount of money currently in your 401(k) plan(s)?

		Age 25 - 49	Age 50 and over	Total
1.	Less than \$1,000	6.3%	1.9%	4.7%
2.	\$1,000 to less than \$10,000	23.1%	13.0%	19.3%
3.	\$10,000 to less than \$25,000	16.5%	11.4%	14.6%
4.	\$25,000 to less than \$50,000	14.9%	12.5%	14.0%
5.	\$50,000 to less than \$100,000	13.7%	16.2%	14.6%
6.	\$100,000 to less than \$150,000	6.0%	9.1%	7.2%
7.	\$150,000 to less than \$200,000	1.9%	7.3%	4.0%
8.	\$200,000 to less than \$250,000	1.3%	3.2%	2.0%
9.	\$250,000 to less than \$500,000	1.5%	7.6%	3.8%
10.	\$500,000 to less than \$1 million	0.3%	3.2%	1.4%
11.	\$1 million or more	0.0%	0.5%	0.2%
12.	Don't know	13.2%	11.4%	12.5%
13.	Refused	1.3%	2.6%	1.8%

**CL1a.** Do you expect to receive payments from a traditional defined-benefit pension plan in retirement? (A traditional pension plan is completely funded by an employer. The employer decides on the investments and guarantees an annual amount to be paid to employees throughout retirement. The amount of the payments is based on salary and the number of years worked for the company.)

		Age 25 - 49	Age 50 and over	Total
1.	Yes (you expect to receive payments from a traditional pension plan)	32.5%	41.7%	36.0%
2.	Yes (you already receive payments)	1.1%	18.5%	7.6%
3.	No	45.7%	33.9%	41.3%
4.	Don't know	21.2%	8.2%	16.3%
5.	Refused	0.2%	0.6%	0.4%

**CL2. Thinking about your retirement savings only (excluding real estate, Social Security, and any traditional defined-benefit pension plans), how much of your retirement savings is in your 401(k) plan(s)?**

In the list below, "**other accounts**" refers to any 401(k) plans provided by your spouse's employer and any savings that you and/or your spouse have in any other types of retirement savings plans or retirement accounts. "**Other accounts**" does **not** include other sources of retirement income, such as real estate, Social Security or traditional defined-benefit pension plans.)

		Age 25-49	Age 50-64	Age 65+
1.	<b>All</b> of your retirement savings is in your 401(k) plan (You have no retirement savings other than your 401(k) plan)	28.7%	16.6%	24.2%
2.	<b>Most</b> of your retirement savings is in your 401(k) plan, but some is in other accounts	28.7%	31.7%	29.8%
3.	<b>Some</b> of your retirement savings is in your 401(k) plan, but most of it is in other accounts	28.8%	41.7%	33.7%
4.	<b>Don't Know</b>	13.0%	9.0%	11.5%
5.	<b>Refused</b>	0.8%	1.0%	0.9%

{BASE: EMPLOYED OR LOOKING FOR WORK OR STUDENT OR OTHER IN SCR3}

**CL3. At what age do you expect to retire completely and not work for pay at all?**  
(Please provide your best guess.)

		Age 25-49	Age 50-64	Age 65+
1.	<b>30-59</b>	11.4%	2.5%	8.5%
2.	<b>60-61</b>	21.3%	6.3%	16.4%
3.	<b>62-64</b>	7.4%	14.8%	9.8%
4.	<b>65</b>	28.2%	24.3%	26.9%
5.	<b>66-69</b>	12.3%	22.2%	15.5%
6.	<b>70 or higher</b>	19.2%	29.2%	22.5%
7.	<b>Refused</b>	0.3%	0.7%	0.4%

## CL4. How long have you had your current 401(k) plan?

(If you currently have money saved in more than one 401(k) plan, please refer to the plan in which you have had money saved the longest.)

		Age 25 - 49	Age 50 and over	Total
1.	Less than 1 year	10.1%	3.3%	7.6%
2.	1 year to less than 3 years	16.2%	7.5%	12.9%
3.	3 years to less than 5 years	15.7%	6.9%	12.4%
4.	5 years to less than 10 years	28.8%	19.8%	25.5%
5.	10 years to less than 15 years	14.0%	21.1%	16.7%
6.	15 years to less than 20 years	9.1%	18.9%	12.8%
7.	20 years or more	3.9%	20.5%	10.1%
8.	Don't know	1.7%	1.6%	1.7%
9.	Refused	0.4%	0.6%	0.5%

{BASE: EMPLOYED IN SCR3}

## CL5. How many total employees work for your current employer at all locations in the U.S.?

		Age 25 - 49 (n=719)	Age 50 and over (n=624)	Total (n=1343)
1.	Less than 10	4.2%	5.3%	4.5%
2.	10 to 49	5.3%	10.4%	7.0%
3.	50 - 99	6.6%	7.5%	6.9%
4.	100 - 499	20.0%	15.4%	18.5%
5.	500 - 2499	15.4%	15.0%	15.3%
6.	2500 - 9999	15.4%	13.3%	14.7%
7.	10,000 or more	23.2%	24.0%	23.4%
8.	Don't know	9.7%	8.5%	9.3%
9.	Refused	0.2%	0.7%	0.3%

{BASE: EMPLOYED IN SCR3}

CL6. In what industry or type of business is your current employer primarily involved?

1.	Agriculture, forestry, fishing, hunting, and related	0.5%	0.3%	0.4%
2.	Mining	0.2%	0.3%	0.2%
3.	Construction	5.0%	5.1%	5.0%
4.	Manufacturing	16.4%	15.1%	16.0%
5.	Wholesale Trade	2.4%	1.6%	2.1%
6.	Retail Trade	9.6%	14.0%	11.0%
7.	Transportation and Utilities	4.3%	7.0%	5.2%
8.	Technology Information and Information Services (e.g., media, publishing, telecommunications, Internet Service providers)	11.0%	8.3%	10.1%
9.	Finance, Insurance, and Real estate	9.5%	5.6%	8.2%
10.	Professional and Business Services (e.g., legal services, marketing, advertising, consulting, bookkeeping, engineering)	7.0%	6.0%	6.7%
11.	Education and Educational Services	6.0%	7.2%	6.4%
12.	Healthcare and Health Services	14.5%	14.8%	14.6%
13.	Leisure and Hospitality (e.g., arts, entertainment, recreation, food services, lodging)	4.1%	5.1%	4.4%
14.	Other (Net)	8.3%	8.8%	8.5%
15.	Refused	1.4%	0.9%	1.2%

CL7. Which of the following best describes your current annual income before taxes including wages or salary, Social Security, pensions, and interest or dividends on savings and investments?

		Age 25 - 49	Age 50 and over	Total
1.	Less than \$10,000	2.5%	3.0%	2.7%
2.	\$10,000 up to \$25,000	11.1%	13.9%	12.2%
3.	\$25,000 up to \$50,000	39.2%	36.0%	38.0%
4.	\$50,000 up to \$75,000	21.8%	21.1%	21.6%
5.	\$75,000 up to \$100,000	15.5%	12.0%	14.2%
6.	\$100,000 up to \$150,000	4.8%	5.9%	5.2%
7.	\$150,000 or more	1.4%	2.8%	1.9%
8.	Refused	3.6%	5.2%	4.2%