



AMERICAN BENEFITS COUNCIL

October 26, 2007

401(K) FEE DISCLOSURE CAN BE ENHANCED BUT REFORMS MUST BE MEASURED AND NOT DETER PLAN SPONSORSHIP AND PARTICIPATION

With the decline of defined benefit plans, 401(k) plans have become the primary retirement plan for millions of Americans. Accordingly, it is more important than ever to take appropriate steps to ensure that 401(k) plans provide Americans with retirement security. The goal of the American Benefits Council is an effective 401(k) system that functions in a transparent manner and provides meaningful benefits at reasonable fee levels. At the same time, we must bear in mind that unnecessary burdens and costs imposed on these plans will slow their growth and reduce participants' benefits.

Plans Are Carefully Reviewing Fees. With respect to 401(k) plan fees, our members -- both plan sponsors and service providers -- report that plan fiduciaries are taking extensive steps to ensure that fee levels are reasonable for participants. Plan fiduciaries are asking hard questions regarding 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.

We Support Enhanced Disclosure. These efforts can be improved -- and any weaknesses in the system addressed -- through even more universal disclosure of meaningful fee information. Plan fiduciaries should receive disclosure of direct and indirect fees that service providers receive from the plan or from unrelated third parties. And participants should receive clear, meaningful disclosure about the fees and investment options in their plans.

Policy Responses Should be Balanced and Practical and Must Be Carefully Coordinated. Several bills have been introduced in recent weeks with the goal of enhancing the disclosure of defined contribution plan fee information. These include The 401(k) Fair Disclosure for Retirement Security Act of 2007 (H.R. 3185) from House Education and Labor Chairman George Miller and The Defined Contribution Plan Fee Transparency Act of 2007 (H.R. 3765) from House Ways & Means Select Revenue Measures Subcommittee Chairman Richard Neal.

The Department of Labor has also been working on a three-part regulatory project to enhance fee transparency. One part, due to be finalized within weeks, would require plans to report to the Department more information about the fees they pay to plan service providers on the annual Form 5500. A second part, due to be proposed later this year, would require disclosure of fee information by service providers to plan fiduciaries, including disclosure of revenue sharing amounts received by providers from third parties. This rule is intended to ensure that plan fiduciaries have all the information they need to pay no more than reasonable compensation to providers. A third part would require clear, meaningful fee disclosure to participants and is expected in proposed form this winter. The Council has worked extensively with the Department to help it improve fee transparency including through submission of joint recommendations with other interested trade associations. We believe that the Department is addressing the key policy issues that have been raised regarding fee disclosure.

The Council will evaluate any legislative or regulatory proposal in light of the principles outlined in this document. We are concerned that certain policy proposals, particularly several of those contained in H.R. 3185, differ from these principles substantially and could both deter plan participation by some employees and have the effect of raising costs for the very participants whose interests we are trying to advance. We also believe it is very important that the legislative and regulatory processes regarding fee transparency be coordinated. For example, it would be very harmful 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.

We Must Not Undermine the Voluntary System. The success of the 401(k) plan system is dependent on the willingness of employers to offer these plans and the willingness of employees to participate. 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. Plan sponsors and participants need clear, meaningful information that is relevant to their decision-making.

We Must Be Sensitive to Increased Costs for Employees and Employers. Every new requirement imposed on 401(k) plans has a cost. And generally it is participants who bear that cost. So it would be unfortunate 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 costs.

Employees and Employers Have Different Roles and Different Informational Needs. The disclosure rules should take into account the sharply different circumstances and needs of participants and plan fiduciaries. Participants need clear, simple, short disclosures that effectively communicate the key information they need to decide whether to participate and, if so, how to invest. 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 prudently choose providers and a menu of investment options on behalf of participants.

Fees Can Only Be Evaluated in the Context of Services Provided. We must avoid evaluating 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 (such as returns, risk, features offered, quality of services, etc.). Fees are very important, but they are only one component of performance. Our objective should be excellent performance and service at a fair price.

Fees Understandably Differ Based on Needed Services and Plan Size. Different workforces need different services. Accordingly, the 401(k) 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. Concerns have been raised about the higher level of fees for smaller plans. Many 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.

Employers and Employees Share the Cost of Defined Contribution Plans. 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 plan participants, such as fees for investments, recordkeeping, participant communications and compliance testing. Many employers voluntarily pay for certain expenses that could be charged to the plan and its participants, such as recordkeeping, 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 participants.

Intense Competition is Driving Costs Down. Competition among investment options and service providers is intense, which has exerted downward pressure on fee levels. In fact, plan investment fees are lower than fees outside the plan context. 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 for Fee Disclosure Reform. Below are a number of additional principles that we believe should govern reform of fee disclosure standards and that the Council is using to evaluate specific legislative or regulatory proposals in this area.

- **Fee Disclosure Should Not Force Artificial Unbundling.** 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.
- **Revenue Sharing Should Be Disclosed.** 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.
- **Promotion of Electronic Delivery.** 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.
- **Expense of Dollars and Cents Figures Often Not Justified.** Where disclosure to participants and plan fiduciaries of exact dollar amounts of fees would be costly, the use of estimates or examples based on prior year data should be permitted.
- **Format Flexibility.** 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.
- **Accommodation of Diverse Investment Products.** 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.
- **Disclosure Should Cover Only Plan-Paid Fees.** 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.