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**STATEMENT OF NORMAN P. STEIN
ON BEHALF OF THE
PENSION RIGHTS CENTER**

**ON THE
“APPROPRIATENESS OF RETIREMENT PLAN FEES”**

**BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES**

OCTOBER 30, 2007

Mr. Chairman, Members of the Committee, I am Norman Stein, a professor at the University of Alabama School of Law, where I am privileged to hold the Douglas Arant Professorship. This semester, I am a visiting professor at Catholic University’s Columbus School of Law here in Washington, D.C. I am appearing today on behalf of the Pension Rights Center, the nation’s only consumer organization dedicated solely to promoting and protecting the retirement security of workers, retirees and their families.

If someone were to look at the discussion of 401(k) plan fees over the past decade, they may well compare it to the weather: It is something that everyone talks about but about which no one has done all that much. It is our hope that this hearing today will put us on the road to improvement of both the disclosure and appropriateness of 401(k) fees. Indeed, we were heartened to see that the topic of this hearing was not merely the disclosure of 401(k) fees, an

issue on which the Center has commented before,¹ but also on the appropriateness of some of those fees. Mere disclosure is often not enough: If fees are too high or otherwise inappropriate, the proper remedy is not disclosure but prohibition or regulation.

Our testimony today will focus on six issues: (1) the effect of fees on retirement savings in 401(k) plans; (2) disclosure of fees to participants; (3) disclosure of fees to fiduciaries; (4) the inappropriateness of charging plan administration fees to participant accounts; (5) the inappropriateness of a Department of Labor field assistance bulletin that allows a plan to charge extraordinary fees to the accounts of individual participants; and (6) the desirability of a government-sponsored, low-fee 401(k)-type service provider, which could provide an alternative to smaller businesses that often lack sufficient bargaining power to negotiate low-fee arrangements with third-party administrators.

1. The Effect of Fees on Retirement Savings

In recent years, think-tanks, commentators, the Government Accountability Office (GAO), and the Department of Labor have developed models and simple illustrations of the dramatic effect of fees on retirement savings. From the standpoint of entities that provide various services to 401(k) plans in the market, a small additional fee can result in substantial profits, because that fee is typically multiplied by the number of participant accounts served. In many cases, a small percentage difference in the cost of a product or service is not particularly meaningful to the consumer, because it is a one-time cost and is not compounded over time. But in the area of 401(k) plans, the fee is charged periodically, and sometimes as often as monthly, over an employee's working life, and the time value of money can turn a nominally insignificant

¹ Pension Rights Center Comments in response to U.S. Department of Labor Request for Information dated July 24, 2007 http://www.pensionrights.org/policy/regulations/401k_fees_RFI/PRC_comments_on_fee_disclosure_RFI.pdf

fee into a significant loss in retirement savings. The GAO, for example, has shown how a one percentage point in fees for an investment with a seven percent before-fee rate of return can reduce retirement savings by 17 percent over a 20-year period of participation. Fees matter.

Although fees matter for all investments, they matter even more for 401(k) plans. That is because the very nature of these plans, where employee contributions flow into the plan each pay period, can conceal the impact of fees. Participants, unaware of how much they are paying in fees, see their accounts grow and assume they are earning significant returns.

2. Participant Disclosure

Disclosure of fees is keenly important to participants. They need this information to determine whether they are getting their money's worth for their 401(k) investments, and to plan realistically for retirement. In addition, participants cannot adequately choose among investment options without relevant fee information. Finally, there is the fact that financially sophisticated participants may be in a position to influence plan decision-makers choice of investment options when the plan's current investment options have high fees.

In our view, automatic participant disclosure should be simple and direct. Too much information can overwhelm an unsophisticated participant and can give even a financially literate participant more information than they need. We suggest that 401(k) participants be provided automatic annual fee disclosure statements that at a minimum include the following:

1. A statement of why fees are important, and that they should be considered along with return and risk characteristics in selecting among investment options;

2. A listing for each investment option offered by the 401(k) plan, the rate of return, net of fees, during for the preceding year;²

3. An individualized statement of the total dollar amount of fees charged to a participant's 401(k) account the preceding year, including all recordkeeping, investment, load, marketing and other fees.³

In addition, it would be helpful for the annual statement to also include

1. Expense ratios for (i) aggregate investment management fees and (ii) for administrative and advisory costs (to the extent paid by the participant);

2. Dollar amounts per \$1,000 for (i) aggregate investment management fees and (ii) for administrative and advisory costs (to the extent paid by the participant).

3. Transaction-oriented fees that are paid when initially purchasing or later disposing of an investment option, with an indication of how high these fees would be if ratably charged on annual basis for investments held for 1, 5, 10, and 15 years.

Finally, participants should be able to request more comprehensive information about fees for particular investment options, with fees disaggregated into uniform categories.

3. *Disclosure to Fiduciaries*

Participants need fee information to help them shape a portfolio from the investment options available under the plan. Plan decision-makers, however, have to choose from the entire

² This could be similar to the format of the “Rates of Return” chart published by the Federal Thrift Savings Plan in its *Highlights* newsletter <http://www.tsp.gov/forms/highlights/high07d.pdf>

³ This type of total dollar disclosure has recently been implemented in Australia. See Corporations Amendment Regulations 2005 (No.1), March 10, 2005 (Australia), Amendment under Corporations Act of 2001, Schedule 1, Part 3, Division 2(302), at p. 25, found at [http://www.frli.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/0/5148FBFAB97F8829CA256FC00022EC72/\\$file/0304600I-050307EV.pdf](http://www.frli.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/0/5148FBFAB97F8829CA256FC00022EC72/$file/0304600I-050307EV.pdf)

universe of available investment vehicles those options that will be made available to plan participants. Moreover, they need periodic information about the investment they have chosen in order to monitor their continuing appropriateness for the plan's participants. Thus, plan decision-makers require detailed information about all fees that are charged to the plan, so that they compare one investment option to another, particularly within classes of investments. In order for them to compare fees across various investment vehicles, the presentation of fees should be uniform from vendor to vendor, with fees divided into separate fees for each type of service provided by the vendor. This would require that fees for bundled services be unbundled. Moreover, it may be appropriate for there to be regulation that requires that each service be available on a bundled or unbundled basis. Discounts for bundled services should be clearly identified.

We also note that participants should be able to request any information on fees that is submitted to the plan.

4. Costs for Administrative Services Should Be Borne by the Plan Sponsor

It may be time to re-evaluate whether a plan sponsor should be able to pass administrative costs on to individual participants or whether these costs should be considered a cost of plan sponsorship. There are four reasons for our views:

1. The employer is the purchaser of plan administrative services without being the actual payor for those services (in plans that pass those costs on to the participants). This is a recipe for market failure, since the employer does not have the maximum incentive to bargain for the lowest possible fees and/or the most appropriate services for the plan.

2. In some cases, particularly with smaller plans, fees can make the cost of investing inside a plan more expensive than investing outside a plan.

3. In defined benefit plans, the employer bears the administrative costs of plan management, either directly if the administrative fees are paid directly, or indirectly if the fees are charged to the plan, since the employer bears the burden of funding the plan. The ability to charge back fees to the participant in a defined contribution plan creates an uneven playing field between defined benefit and defined contribution plans. In our view, the administrative costs of plan sponsorship should be a cost of doing business.

4. When employees decide among employment opportunities, they will generally compare section 401(k) plans based on the employer match and not on whether the employer bears the administrative costs of plan sponsorship, something that even sophisticated job seekers are unlikely to consider (or have the information to consider). Requiring employers to bear the administrative costs as a normal cost of doing business will increase the accuracy of employee evaluation of 401(k) plans offered by different employers.

5. Field Assistance Bulletin 2003-3

In 2003, the Department of Labor issued a Field Assistance Bulletin that reversed long-standing rules on what types of individual costs could be charged as fees to individual participants. That Field Assistance Bulletin, which did not go through the normal regulatory process in which a change of position is first published in the Federal Register and comments from all stakeholders solicited and considered, adopted positions that in our view were ill-considered and that can have unfair and, in some cases, devastating impact on the retirement security of some plan participants.

The most objectionable of the holdings in this Bulletin was that the plan's cost of a qualified domestic relations order could be charged directly to the account of the participant. These fees can be substantial and in some cases could reduce the value of a modest retirement account to zero. We urge the Committee to review this Bulletin and consider recommending that the Department of Labor withdraw it and return to its prior interpretation of when fees can be charged solely to the individual accounts of particular participants.

6. Low-Cost Provider

The economist Christian Weller, and others, have proposed that legislation make available to small firms that provide 401(k)s an option to access large, governmental third-party service providers. This would make available the economies of scale realized by large employers. For example, the Federal Thrift Savings Plan or the defined contribution plans of state retirement systems might allow participation by the employees of private employers. The availability of such an alternative might also have ripple effects in the market, as service providers lower fees to make their products more competitive to smaller employers.