THE APPROPRIATENESS OF RETIREMENT PLAN FEES

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

OCTOBER 30, 2007

Serial 110–64

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

49–691 WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON WAYS AND MEANS

CHARLES B. RANGEL, New York, *Chairman*

FORTNEY PETE STARK, California
SANDER M. LEVIN, Michigan
JIM MCDERMOTT, Washington
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
MICHAEL R. MCNULTY, New York
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
EARL POMEROY, North Dakota
STEPHANIE TUBBS JONES, Ohio
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
RAHM EMANUEL, Illinois
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL, JR., New Jersey
SHELLEY BERKLEY, Nevada
JOSEPH CROWLEY, New York
CHRIS VAN HOLLEN, Maryland
KENDRICK MEEK, Florida
ALLYSON Y. SCHWARTZ, Pennsylvania
ARTUR DAVIS, Alabama

JIM MCCRERY, Louisiana
WALLY HERGER, California
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
SAM JOHNSON, Texas
PHIL ENGLISH, Pennsylvania
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri
RON LEWIS, Kentucky
KEVIN BRADY, Texas
THOMAS M. REYNOLDS, New York
PAUL RYAN, Wisconsin
ERIC CANTOR, Virginia
JOHN LINDER, Georgia
DEVIN NUNES, California
PAT TIBERI, Ohio
JON PORTER, Nevada

JANICE MAYS, *Chief Counsel and Staff Director*
BRETT LOPER, *Minority Staff Director*

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also published in electronic form. *The printed hearing record remains the official version.* Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

CONTENTS

THE APPROPRIATENESS OF RETIREMENT PLAN FEES

TUESDAY, OCTOBER 30, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS
Washington, DC.

The Committee met, pursuant to notice, at 10:00 a.m., in room 1100 Longworth House Office Building, Hon. Charles B. Rangel (Chairman of the Committee), presiding.

[The advisory of the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE | CONTACT: (202) 225–1721
October 24, 2007
FC–16

Chairman Rangel Announces a Hearing on the Appropriateness of Retirement Plan Fees

House Ways and Means Committee Chairman Charles B. Rangel today announced that the Committee on Ways and Means will hold a hearing on the appropriateness of fees that are charged to the pension plans of workers who participate in 401(k), 403(b), and 457 plans. **This hearing will take place on Tuesday, October 30, 2007, in 1100 Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. A list of invited witnesses will follow.

FOCUS OF THE HEARING:

This hearing will focus on the impact that administrative and investment fees have on workers' ability to adequately save for their retirement.

BACKGROUND:

Over the past two decades, 401(k) plans have grown to be the most popular form of defined contribution (DC) retirement savings plans. As of 2006, approximately 50 million American workers actively participated in a 401(k) plan, with an asset value of $2.753 trillion, which represents 16 percent of all retirement assets.

Other common forms of DC plans are 403(b) annuity and 457 plans. According to a report by the Spectrum Group, there were approximately 31,450 Section 457 plans in 2000. This market has grown over the last 7 years, as reflected in a recent report by the Employee Benefit Research Institute (EBRI) that examined 2004 data. The report estimated total Section 457 plan assets to be about $117 billion. More recent data on 457 plans for the first quarter of 2007 show assets of $161 billion, with more than 3.8 million participants. According to recent data released by the Investment Company Institute, Section 403 (b) plans held assets valued at $701 billion, with approximately 5.5 million workers participating in these plans.

The growth in DC plans has resulted in a shift of the burden of saving for retirement. Today, the role of employers in these plans is shrinking while the role of the workers increases. The majority of workers who participate in these plans are responsible for making sure they set aside adequate savings to finance their retirement years. This includes making wise investment choices and monitoring account activity to ensure efficient use of funds. These funds can be easily eroded through excessive investment costs.

According to the Bush Administration's budget for fiscal year 2007, Federal tax expenditures for 401(k) plans were estimated at $39.8 billion for 2007 and a total of $233 billion over the next five years. Other employer-sponsored plans, including 403(b) and 457 plans, were estimated to cost $52.4 billion for 2007 and a total of $228 billion over the next five years.

As assets in DC plans grow, so does the Federal subsidy for the savings held in these plans. The Committee is charged with the task of ensuring that these Federal tax subsidies are used as intended under the Internal Revenue Code.

In announcing the hearing, Chairman Rangel said, **"This is an important issue for millions of American workers who are being asked to shoulder the cost of saving adequately for their retirement. If we are going to ask our workers to fully take on this level of responsibility, and the Federal Government is going to subsidize these efforts, we have a duty to make sure that our Federal dollars are efficiently and effectively working for the benefit of our workers. We need to make sure that these subsidies are being reflected in the account balances of these workers."**

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "110th Congress" from the menu entitled, "Committee Hearings" (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You MUST REPLY to the email and ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Tuesday, November 13, 2007**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman RANGEL. The Committee on Ways and Means will come together as we review the plan fees, how reasonable they are, and how we can protect our retirement system. We have now over 700,000 plans serving more than 55 million workers, involving billions of dollars, and of course the excessive fees would erode these savings. Our Committee has a responsibility to see whether the Federal subsidy is fully going to the Beneficiaries, rather than in the hands of management, with assets of $2.5 trillion. Just a one percent rate of excess fees will divert $25 billion away from the workers. So, this hearing is to help us to have a better understanding of the problem so that we can work together with other Committees of jurisdiction to make certain that what we are subsidizing benefits the workers and not the management alone. So, I would like to yield to the Ranking Member, Jim McCrery, and I look forward to working with him in a bipartisan way. After he concludes, I would like to yield to Chairman Jim McDermott, who has spent a lot of time and has put a lot of good work into this problem and its solution. Mr. McCrery?

Mr. MCCRERY. Thank you, Mr. Chairman. Today, our Committee will examine the fees that are charged within defined contribution retirement plans, what valuable services are being provided in exchange for those fees, how those fees are disclosed to both plan sponsors and participants and what the government is doing to ensure that workers' savings are not eroded by excessive fees. These are necessarily complex issues, requiring a comprehensive analysis by the Committees of jurisdiction. This hearing will provide us with a better understanding of the intersection of retirement savings and the tax code. There is an expression I think that has been around here quite a while among policymakers and repeated often among staff and even lobbyists and that is that pension issues have always been bipartisan. This hearing is a perfect example of that sentiment. I want to thank Chairman Rangel and his staff who have worked so hard to put together this hearing and who have reached out to me and my staff from day one. Many of the witnesses here today are at our joint request. We welcome them and appreciate their contributions.

Over many years, this Committee has provided tax preferred tools for Americans to save for their retirement. Employer-sponsored defined contribution plans like 401(k)s, 403(b)s, and 457 plans enable workers to build nest eggs. The system is designed to make saving every pay period attractive, easy and rewarding. This is a success story. People are taking advantage of the savings opportunities we have provided them through the Tax Code. Participation is up. Workers are benefiting from the personal investment advice and automatic enrollment provisions we enacted as part of the Pension Protection Act of 2006, as well as a higher savings limits first enacted in 2001 and then made permanent in the Pension Protection Act.

I am also encouraged that with respect to retirement plan fees and their disclosure to plan sponsors and participants, various government agencies are working together. They are listening to each other, considering all points of view. I look forward to hearing about those efforts today. The Congress, through its Committees of jurisdiction, has a responsibility to ensure our policy goals for tax preferred retirement plans are being realized.

Mr. Chairman, on the issue of helping Americans save, as on so many other important issues facing the country, I look forward to continuing our work together. I yield back and hope that the Committee will greet our witnesses, our great many witnesses today with enthusiasm and a search for understanding of these complex issues. Thank you.

Chairman RANGEL. Thank you, Mr. McCrery. I think we are on common bipartisan ground, these Committees, especially the 401(k)s were initiated to have private citizens assume more of their responsibility in their retiring years. Our Committee is there to provide the incentives to encourage them to do this. Certainly if we have found abuse in the system, there is no reason to believe why the Administration and Democrats and Republicans alike would not want to work together. So, I appreciate the outstanding quality of witnesses that we have before us today. I thank you not only for your written statements and your testimony, but I am hoping that you continue to work with our staffs in a bipartisan way so that we can come up with a solution that will have for political setbacks. As always, is when we are trying to correct something where people unfairly benefit, but if we act in a cooperative way and a bipartisan way, I am certain that the American people would believe that we are trying to do the right thing, so I thank you for the work that you have engaged in this subject already, and I want you to share the benefit of that experience with us to make certain that we are on the right track.

At this time, I will ask that Chairman Jim McDermott to continue to chair this meeting and allocate the time as he and the Ranking Member would see fit. Mr. McDermott?

Mr. MCDERMOTT [presiding]. Thank you very much, Chairman Rangel. We are here today to address a pocketbook issue affecting an increasing number of Americans because our laws simply have not kept pace with the changes in the American economic landscape. We know today that America's future retirees will need to rely upon their personal savings more than any time since the second World War. Here is why: If you turn your attention to the monitors, you can see in graphic detail how pension plans have changed. Over the last 25 years, the availability of traditional defined benefit pension plans have plummeted from about 30 percent down to 5 percent,—if you look at the chart up there, you will see the red line—and so has the participation by the American people. In 1980, it was 30 percent and now we are at 5 percent.

Now, defined contribution plans, 401(k) plans have basically replaced them and that is what that yellow line is on the graphic. The risk of retirement security has been shifted from employers to employees, workers. We are talking about the amount of money people have to live on and this shift of personal plans dramatically emphasizes the need to make every invested dollar count. So, it is critically important for people to consider the cost of administering a 401(k) plan and who pays the cost. The answer to these questions are startling.

First, let's look at the next slide. In a very recent survey, July 2007, AARP determined that 83 percent of participants did not even know how much they were paying in fees. They absolutely were ignorant of what the plan was costing them. In fact, 65 percent of the participants thought they paid no fees at all.

Let me reiterate a shift in our economy to personal plans dramatically emphasizes the need to make every invested dollar count and grow. These fees, which come in all shapes and sizes, often seem relatively small but this next slide shows the impact. Now, even a 1 percent difference, and that slide is a little hard to see, but if you put $20,000 in and then let it accumulate over the next 20 years. A 1 percent difference in fees will amount to $12,000. So, we are talking about a huge amount eaten up by these fees, and people are basically unaware of it. The Chairman is raising an issue today of whether we should require more disclosure of the fees associated with defined contribution pension plans and it is important and very timely.

My colleague, Mr. Neal, and others is ahead of the curve and has already introduced legislation as did Chairman Miller of the Education and Labor Committee. So, I am looking forward to your testimony today because we must be sure that today's workers and tomorrow's retirees are adequately empowered and enabled to understand, invest and prepare for their retirement needs.

We have a very distinguished panel to begin with today. The first of our panelists is the Honorable Bradford Campbell, who is the Assistant Secretary of Labor for employee benefits at the Department of Labor; Mr. Reeder is a Benefits Tax Counsel for the Office of Tax Policy at the Department of Treasury; Andrew Donohue is the benefits—or is the Division of Investment Management of the U.S. Securities and Exchange Commission; and Barbara Bovbjerg is the Director of Education and Workforce and Income Security issues for the government Accountability Office (GAO). So, Mr. Campbell, we look forward to your testimony. Your full testimony will be put into the record. We would like you to try and keep your testimony to 5 minutes and then we will turn the crew loose on you for questions.

Mr. Campbell?

STATEMENT OF THE HONORABLE BRADFORD P. CAMPBELL, ASSISTANT SECRETARY OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. CAMPBELL. Yes, sir. Thank you, Mr. Chairman, Mr. McDermott, Mr. McCrery and the other Members of the Committee for this opportunity to testify today to discuss the Department of Labor's significant progress 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 significant changes, as Mr. McDermott noted, that affect both workers and plan fiduciaries. More workers now control the investment of the retirement savings and participant-directed individual account plans, such as 401(k) plans, and at the same time the financial services marketplace has increased in complexity. Plan fiduciaries, who are charged by law with responsibility for making prudent decisions when hiring service providers and for paying only reasonable plan expenses, have found their jobs more difficult as the number and types of fees proliferate and as relationships between service providers become more complex.

These trends cause the Department to conclude that despite the success of our fiduciary outreach and education efforts, a new regulatory framework was necessary to better protect the interest of America's workers, retirees, and their families. That is why we initiated three major regulatory projects, each addressing a different aspect of this problem.

The first regulation addresses the needs of participants for concise, useful disclosures, comparative information that helps them choose between their plan options. The second addresses the needs of plan fiduciaries who require more comprehensive disclosures by service providers to enable them to carry out their duties under the law to assess whether the cost of services are necessary, appropriate and reasonable.

The third regulation addresses disclosures made by plan administrators to the public and the government via the Form 5500, the annual report filed by pension plans with the Department of Labor. It is essential to understand that the disclosure needs of each of these groups are different and that therefore the disclosures that we will require in our regulatory process are also different.

Participants are choosing investments from among a defined universe of plan options and to do this they need concise summary information that allows them to compare these options in meaningful ways, taking into account the fees, the historical rates of return, the nature of the investment, and other information relevant to that decision. Plan fiduciaries are trying to decide if the services that they are receiving and the prices they are charged are reasonable and necessary, taking into account the needs of the plan as a whole.

The fiduciaries also need to know whether the services that are provided will be influenced by compensation arrangements between the plan and third parties and the nature of the services provided their necessity and the reasonableness of the fees. The process by which plan fiduciaries make these prudent decisions necessitates a very detailed and comprehensive disclosure.

Earlier this year, we issued a Request For Information on participant level disclosures and there appears, based on the responses we received, to be basic agreement that participants generally will not benefit from lengthy disclosure documents that contain large quantities of legalese and detailed information because they simply will not be used. Because participants typically bear the cost of producing these disclosure materials, doing so in that way could perversely have the effect of increasing plan fees without providing additional utility.

I wanted to make sure that the Committee understands that we are not at the beginning of these regulatory projects, we are actually quite far advanced in the process. One of the three regulations will be final in the next several weeks, dealing with the disclosure to the public. We will also—we have completed drafting, and currently the Administration is reviewing and we will promulgate in the next several months these service provider disclosures to plan fiduciaries proposed regulation. We have also concluded, as I mentioned, the Request For Information on participant level disclosures and anticipate issuing a proposed regulation in this area this Winter.

I want to commend the Committee for its interest in this issue, but I also want to note that it is not necessary for there to be additional legislation for the Department to engage in these regulatory projects. We have the authority under current law to do so. I believe that our regulatory initiatives will address the issues that have been raised thus far and Congress' consideration of these issues. I think also given the technical nature of many of the issues presented, the regulatory process is well suited to resolving many of the concerns that have come up. It is deliberative, it is open, it is inclusive in its design to resolve many of these complex issues.

If the Committee does choose to pursue legislation, I would ask that it bear in mind the work that we have already done as it considers these issues.

In conclusion, Mr. Chairman, I would like to thank you and Mr. McDermott and Mr. McCrery, you and your colleagues for your interest in this issue because it is very important to ensuring adequate retirement security for America's workers. I am committed personally to ensuring that our regulatory projects are completed in a timely manner. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Campbell follows:]

WRITTEN TESTIMONY OF BRADFORD P. CAMPBELL
ASSISTANT SECRETARY OF LABOR
BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

October 30, 2007

Introductory Remarks

Good morning Chairman Rangel, Ranking Member McCrery, and Members of the Committee. Thank you for inviting me to discuss plan fees, the Department of Labor's role in overseeing plan fees, and proposals 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. In the next several months we will 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.

The Employee Retirement Income Security Act of 1974 (ERISA) provides the Secretary 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.[1] 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.

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.

---

[1] Based on 2004 filings of the Form 5500.

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 investments available under the plan, 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[2] 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.

[2] *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).

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.

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 connection with this initiative, EBSA is also working with the Securities and Exchange Commission 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 and Pension Benefit Guaranty Corporation 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 Internal Revenue Service, the Department of Justice (including the Federal Bureau of Investigation), the Securities and Exchange Commission, 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.

Concerns Regarding Legislative Proposals

While I am pleased that the Department's regulatory initiatives and the legislative proposals introduced in Congress share the common goal of providing increased transparency of fee and expense information, I am concerned that legislative action could disrupt the Department's ongoing efforts to provide these important disclosures. I am also concerned by proposals that would mandate specific investment options -- limiting the ability of employers and workers together to design plans that best serve their mutual needs -- or that would mandate lengthy, detailed disclosures to participants. Participants are most likely to benefit from concise disclosures that allow them to meaningfully compare the investment options in their plans. In response to our April Request for Information, the Department received many comments highlighting the importance of brevity and relevance in disclosures to participants. The regulatory process is well-suited to resolving the many technical issues arising as we seek to strike the proper balance in providing participants with cost effective, concise, meaningful information.

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.

Mr. MCDERMOTT. Thank you very much for your testimony. Thank you.

Mr. Reeder?

STATEMENT OF W. THOMAS REEDER, ESQ., BENEFITS TAX COUNSEL, OFFICE OF TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. REEDER. Mr. Chairman, Ranking Member McCrery, Members of the Committee, I appreciate the opportunity to appear today to discuss retirement plan investment fees and other expenses paid by participants and sponsors in tax preferred retirement plans. The administration commends this Committee in promoting the facilitation of establishment of retirement savings plans by as many employers as possible and encouraging participation in those plans by as many workers as possible. Transparency of the cost of investing the assets of these plans is certainly an important factor in making employer-sponsored savings plans more attractive to employers and workers.

The Employee Retirement Income Security Act 1974, or ERISA, established minimum reporting, disclosure, fiduciary, and tax rules related to retirement plans, as well as remedies for violation of those rules. Responsibility for the interpretation and enforcement of ERISA was divided among the Labor Department, the Treasury Department, and the Pension Benefit Guaranty Corporation Originally, ERISA granted dual jurisdiction to both the Labor and Treasury Departments over certain issues but shortly after ERISA's enactment, the ERISA Reorganization Plan No. 4 1978 allocated responsibility for particular issues between the two departments. The division of jurisdiction between Labor and Treasury has evolved into a balance that works very well to capitalize on the expertise in those two departments.

Pursuant to ERISA and the Reorganization Plan, the Labor Department has primary jurisdiction over the reporting, disclosure, and fiduciary responsibility rules of ERISA. Nonetheless, the Treasury Department certainly shares with its partner agency the goals of minimizing plan expenses. The Internal Revenue Code contains substantial favorable tax treatment for retirement savings, and we all are working to maximize the efficiency of that favorable treatment. Dollars spent on plan fees, as has already been pointed out, and expenses are dollars not available for retired Americans. Over time, excessive or hidden fees will significantly erode a worker's retirement savings.

At Treasury and the IRS, we have worked hard to reduce the cost of sponsoring and maintaining tax qualified retirement plans. For example, we continue to expand plan sponsors' ability to use pre-approved plans, which are much less expensive to sponsor and maintain than individually designed plans. We developed and continued to refine a correction program under which plan sponsors can voluntarily correct qualification problems in a structured, predictable, cost-effective manner rather than having to disqualify the plan completely.

As described in more detail in my written testimony, we have also specifically addressed and continue to consider options for addressing plan fees and expenses in a limited number of contexts within the Treasury Department's jurisdiction.

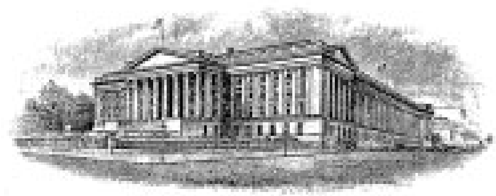
We appreciate the Committee's concern for enhancing participant disclosure and providing transparency of cost information. At the same time, we share the Labor Department's concern that legislation in this area could disrupt the Labor Department's significant ongoing deliberative efforts to enhance disclosures of plan fees. We are also concerned that the cost of additional disclosure will ultimately be borne by plan participants. In designing any new disclosure requirements, the expected participant cost should be carefully weighed against expected benefits to participants of additional disclosure. Excessive disclosures related to plan fees and costs could be confusing and thus could actually impair rather than enhance a worker's ability to make informed decisions regarding their plan investments.

Moreover, while fees and other costs are very important factors in a plan sponsor's choice of third party investment and administrative service providers and in a participant's choice of particular investment options, these costs are not the only factors: customer service, reliability, accuracy, communications, returns, management continuity and quality, and many other factors may be appropriate for plan sponsors and participants to consider. Care should be taken in structuring disclosure requirements so that fees and costs are not over emphasized.

In conclusion, we look forward to working within the administration, as well as with Congress, to address issues regarding plan investment fee transparency in a manner that facilitates the establishment of more plans and maintenance of those plans by American employers for their workers and facilitates participation in these programs by their workers.

I appreciate the opportunity to appear today, and I will be happy to answering any questions you may have.

[The prepared statement of Mr. Reeder follows:]



U.S. Treasury Department Office of Public Affairs

Embargoed Until 10 a.m. October 30, 2007
Contact Andrew DeSouza (202) 622-2960

Testimony of Treasury Benefits Tax Counsel W. Thomas Reeder Before the House Ways and Means Committee on Retirement Plan Fees and Expenses

Washington, DC— Chairman Rangel, Ranking Member McCrery and Members of the Committee, I appreciate the opportunity to appear today to discuss retirement plan fees and expenses, and the transparency of those costs to plan participants and sponsors.

Background

The Administration is committed to facilitating the establishment of retirement savings plans by as many employers as possible and encouraging participation in those plans by as many workers as possible. Transparency of the cost of investing the assets of those plans is an important factor in making employer-sponsored savings plans more attractive to employers and their employees.

The Labor Department has primary jurisdiction over most issues relating to retirement plan fees and expenses, and the disclosure of plan fee and expense information to plan sponsors and plan participants. The Employee Retirement Income Security Act of 1974 ("ERISA"), as originally enacted, established minimum standards for retirement plans and provided extensive rules on the federal income tax effects of retirement plan transactions. ERISA was enacted, in part, to protect the interests of retirement plan participants and their beneficiaries by requiring the disclosure of financial and other information concerning the plan, establishing standards of conduct for plan fiduciaries, and providing for appropriate remedies. Responsibility for the interpretation and enforcement of ERISA was divided among the Labor Department, the Treasury Department, and the Pension Benefit Guaranty Corporation. Originally, ERISA granted dual jurisdiction to both the Labor and Treasury Departments over certain issues, but, shortly after its enactment, the ERISA Reorganization Plan No. 4 of 1978 allocated and transferred responsibility for particular issues between the Labor and Treasury Departments. Pursuant to ERISA and the Reorganization Plan, the Labor Department has primary jurisdiction over the reporting, disclosure, and fiduciary responsibility rules of ERISA. The division of jurisdiction between the Labor and Treasury Departments has evolved into a balance that works well.

Treasury Department Activities Regarding Plan Costs and Fees

Although the Labor Department has primary jurisdiction over disclosure issues, the Treasury Department certainly shares the goals of minimizing plan expenses, through accurate and meaningful disclosure of information to plan participants, plan sponsors, and the federal government. The Internal Revenue Code ("Code") contains substantial favorable tax treatment for retirement savings, and we all are working to maximize the efficiency of that treatment. Dollars spent on plan fees and expenses are dollars not available for retired Americans and, over time, excessive fees will significantly erode a worker's retirement savings.

At the Treasury Department, we strive to work with plan sponsors and plan service providers to reduce the costs of sponsoring and maintaining tax-qualified retirement plans, including plans that include cash or deferred arrangements under Code section 401(k). For example:

- We continue to expand plan sponsors' ability to use pre-approved plans (which are less expensive to sponsor and maintain than individually designed plans).

- We developed, and continue to refine, a voluntary correction program under which plan sponsors can voluntarily correct qualification failures in a structured, predictable, cost effective manner rather than having the plan completely disqualified.

- We have issued guidance on safe harbor 401(k) plan designs that permit plan sponsors to avoid complicated and costly nondiscrimination testing. Under these safe harbors, minimum employer matching contributions or employer non-elective contributions are made to non-highly compensated employees. We are also working to provide guidance on a new safe harbor 401(k) plan design that was approved by Congress last year – so-called automatic enrollment arrangements. Under these arrangements, workers automatically participate in their employer-sponsored 401(k) plan unless they take affirmative action to opt out of elective contributions. Sponsors that make minimum required employer matching contributions or employer non-elective contributions can avoid costly nondiscrimination testing. We are working to help sponsors implement this kind of arrangement by, for example, preparing a participant-friendly sample notice that explains how this kind of plan design works.

We have also specifically addressed – or are considering options for addressing – plan fees and expenses in a limited number of contexts within the Treasury Department's jurisdiction. For example:

- We issued guidance in Revenue Ruling 2004-10 clarifying that a plan may not allocate the expenses of active employees among all plan participants, while allocating the expenses of former employees only among plan participants who are former employees. Allocating expenses in this manner would violate the rule that a plan sponsor may not impose a "significant detriment" on an individual's decision to leave his or her plan benefits in the plan (rather than taking a distribution).

- We are coordinating with the Labor Department on guidance regarding the option under the Pension Protection Act of 2006 that allows plan sponsors to permit individuals who are automatically enrolled in a 401(k) plan to withdraw those contributions within a 90-day window period. The guidance will likely limit the imposition of any fees or expenses on amounts withdrawn under these rules.

- We are working to issue guidance regarding new rules under Code section 401(a)(35) to permit participants to diversify plan investments in employer securities. We have received comments relating to the assessment of employer stock-fund fees that differ from fees assessed on other kinds of plan investment funds. We are considering these comments in light of the new requirement that plan participants not be unreasonably encouraged or discouraged from investing in employer securities.

- Section 1102(b) of the Pension Protection Act of 2006 requires that the description of a participant's right, if any, to defer receipt of a distribution under Code section 411 must also describe the consequences of failing to defer such receipt. In Notice 2007-7, the Treasury Department and the Internal Revenue Service (IRS) provided a safe harbor for satisfying this new notice requirement under which a defined contribution plan would include a description indicating the investment options available under the plan, including employer subsidized fees, that will be available if distributions are deferred.

- The Treasury Department and the IRS are currently working on a guidance project addressing whether a "wrap" or asset-based fee (as opposed to a brokerage-based fee) will be deemed to be a contribution to an IRA if the fee is paid outside of the IRA and, if not, whether it will be deductible. We hope to have this guidance finalized within the coming nine months.

We appreciate the Committee's concern for enhancing participant disclosure and providing transparency of fee and expense information. At the same time, we share the Labor Department's concern that legislation in this area could disrupt the Labor Department's significant ongoing efforts to require enhanced disclosures of plan fees and costs.

Specifically, we believe that overly detailed, lengthy disclosures on plan fees and costs may impair, rather than enhance, participants' ability to make informed decisions regarding their participant-directed plan investments. We are also concerned that additional disclosure costs, and the costs of anticipated related litigation, will ultimately be borne by plan participants. These expected participant costs should be weighed carefully against expected benefits to participants of additional disclosure.

While fees and other costs are very important factors in a plan sponsor's choice of third-party investment and administrative service providers and a participant's choice of particular investment options, those costs are not the only factors. Customer service, reliability, accuracy, communications, returns, management continuity and quality, and many other factors may appropriately inform sponsor and participant decisions. Care should be taken in structuring disclosure requirements so that fees and costs are not over-emphasized.

At the broadest level, the creation of a new bureaucracy that duplicates responsibilities of Labor Department, the Treasury Department, and other government agencies carries the risk of inconsistency, delay, and error.

There have been recent reports of undisclosed fees, penalties, and restrictions in defined contribution plans sponsored by State and local governmental entities, which are not subject to Title 1 of ERISA and thus not subject to the disclosure rules administered by the Labor Department. The exception from ERISA of governmental plans (as well as most plans sponsored by churches) was a conscious decision by Congress in enacting ERISA. State and local legislative bodies have been left to regulate these plans, and we do not propose to apply federal fiduciary rules to those plans. We note, however, that most types of tax preferred defined contribution plans, including those sponsored by governments and churches, must be operated for the exclusive benefit of employees or their beneficiaries. It is conceivable that certain excessive or hidden fee arrangements under which the fees are paid with plan assets and are not used for the exclusive benefit of employees or their beneficiaries could violate that standard. However, plan disqualification would adversely affect innocent participants. State enforcement mechanisms are more effective than the Internal Revenue Code at appropriately addressing these issues with respect to State and local government plans.

We look forward to working within the Administration and with Congress to address issues regarding plan investment fee transparency in a manner that facilitates the establishment and maintenance of retirement savings plans by American employers for their employees and facilitates participation in these programs by American workers.

Conclusion

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear today, and I will be happy to respond to any questions.

-30-

Mr. MCDERMOTT. Thank you very much for your testimony, Mr. Reeder.

Mr. Donohue?

STATEMENT OF ANDREW J. DONOHUE, DIRECTOR, DIVISION OF INVESTMENT MANAGEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. DONOHUE. Chairman Rangel, Ranking Member McCrery, Mr. McDermott, and Members of the Committee, I am pleased to be here today to discuss the Securities and Exchange Commission's perspective on the challenge of helping workers invest for their retirements. With a rapidly aging workforce, you have rightly identified this as an issue of current concern.

In the 21st century, Americans will live significantly longer than their parents and longer than most of them planned for their retirement. A number of older Americans will face difficulties in making their retirement assets last an extra decade or more.

Last year, the SEC launched the Seniors Initiative to address these issues from a number of angles, from investor education, to targeted examinations, to aggressive enforcement efforts. The hallmarks of this initiative have been partnership with other agencies like the relationship we have built with the Department of Labor with respect to our ongoing examination of the adequacy of disclosures available to investors concerning mutual funds and other investment vehicles in a typical defined contribution retirement plan.

A significant part of the Commission's regulatory responsibilities with respect to mutual funds involve the development and administration of mutual fund disclosure requirements. With over 96 million Americans investing in mutual funds for their retirements, their children's education needs, and their other basic financial roles, it is important that mutual fund disclosure is effective. As a result, fund investors, including those who invest through defined contribution plans, should receive clear, concise and meaningful disclosure about key fund information.

Today, I will outline the Mutual Fund Disclosure Reform Initiative that my staff is preparing for Commission consideration, and the way in which it could prove to be helpful in the defined contribution plan marketplace.

In recent years, numerous commentators have suggested that investment information that is central to an investment decision should be provided in a streamline document with other more detailed information provided elsewhere. Furthermore, recent investor surveys indicate that investor prefer to receive information in consider, user-friendly formats.

To gather perspectives from the public, in June of 2006, the Commission held a roundtable on interactive data and mutual fund disclosure reform issues. At the roundtable, representatives from investor groups, the mutual fund industry, analysts and others discussed how the Commission could change the mutual fund disclosure framework so that investors would be provided with better information.

Significant discussion at the roundtable concerned the importance of providing mutual fund investors with access to key fund data in a shorter, more easily understandable format. The participants focused on the importance of providing mutual fund investors with shorter disclosure documents containing key information with more detailed disclosure documents available to investors who choose to review the additional information. Roundtable participants identified the most important information that investors are likely to need to make an investment decision, such as information about a mutual fund's fees and investment objectives and strategies, risks and performance.

We have also benefited from the work of a Mutual Fund Task Force organized by the National Association of Securities Dealers (NASD). This Task Force concluded that investors would benefit from the creation of a profile plus document that would be available on the Internet and would include, among other things, basic information about a fund's investment strategies, risks and total cost with hyper links to additional information on the fund's prospectus.

The Commission is examining ways to reform the mutual fund disclosure framework. The goal of this examination is to find the best way to get investors a concise summary document containing key information about a fund described in plain English and in a standardized order. The key information contained in a concise mutual fund summary potentially could include a fund's fees and investment objectives and strategies, risks and performance. This reform initiative is intended to provide investors with information that is easier to use and more readily accessible while retaining the comprehensive quality of the information available today. This should help investors who are overwhelmed by the choices among funds, which are too often described in lengthy and legalistic prospectuses. A concise mutual fund summary could enable investors to readily access key information that is important to an informed investment decision, including information about fund fees.

If the Commission determines to propose the reformed mutual fund disclosure framework, I am hopeful that we will receive helpful public comment on the utility of the proposed approach. As the staff works to develop a reform initiative, we will do it with a view toward making it useful for all fund investors, including those in defined contribution plans. Along these lines, my staff and I have been working with the Employee Benefits Security Administration of the Department of Labor (EBSA). We keep EBSA apprised of our progress on the mutual fund disclosure reform initiative. We also have been discussing how a concise mutual fund summary could dovetail with EBSA's efforts in the defined contribution plan market. The work with EBSA has been helpful, cooperative, and mutually beneficial. Our staff and I will continue to work with Assistant Secretary Campbell and the EBSA as we move forward on mutual fund disclosure reform.

Thank you for this opportunity to appear before the Committee, and I would be happy to answer any questions you may have.

[The prepared statement of Director Donohue follows:]

Testimony Concerning
Improving Disclosure
for Workers Investing for Retirement

Andrew J. Donohue
Director
Division of Investment Management
U.S. Securities & Exchange Commission

Before the Ways and Means Committee
U.S. House of Representatives

October 30, 2007

Chairman Rangel, Ranking Member McCrery, and Members of the Committee:

I am pleased to be here today to discuss the Securities and Exchange Commission's perspective on the challenge of helping workers invest for their retirements. With a rapidly-aging workforce, you have rightly identified this as an issue of current concern. Some Census numbers released earlier this year provide a sense of the magnitude of the issues presented by the aging of the American population. In 2006, there were more than 37 million Americans age 65 and older, accounting for 12% of the total population. There were five million people age 85 and older, nearly two million in their nineties, and over 73,000 Americans age 100 or older. Today, households led by people over 40 already own 91% of America's net worth, and Americans aged 55 - 64 have the highest income and the highest net worth of any age group, according to the Federal Reserve's Survey of Consumer Finances. As the baby boomers continue to age, it will be a very short while before the vast majority of the nation's savings are in the hands of America's elderly.

With longevity now the norm in our country, it will be increasingly important to protect retirement nest eggs. In the 21st century, Americans will live significantly longer than their parents – and longer than most of them planned for their retirement. A number of older Americans will face difficulties in making their retirement assets last an extra decade or more. While Americans 65 and older hold a record high of $15 trillion in assets, nearly a third of them say they do not have enough money even to meet their basic living expenses.

Last year the SEC launched a Seniors Initiative to address these issues from a number of angles – from investor education, to targeted examinations, to aggressive enforcement efforts. The hallmarks of this initiative have been partnerships with other agencies like the relationship we have built with the Department of Labor with respect to our ongoing examination of the adequacy of disclosures available to investors concerning mutual funds and other investment vehicles in a typical defined contribution retirement plan.

The historic shift from company-guaranteed pension plans to investor-directed vehicles such as 401(k) plans and other defined contribution retirement plans has made this examination particularly important. Americans already invest well over $3 trillion through these defined contribution retirement plans and over half of that is invested in mutual funds. The SEC is committed to making sure that today's retirees, and tomorrow's, have the information they'll need to manage successfully their savings through a retirement that, actuarially speaking, will be far longer than their parents'.

A significant part of the Commission's regulatory responsibilities with respect to mutual funds involves development and administration of mutual fund disclosure requirements. With over 96 million Americans investing in mutual funds for their retirements, their children's education needs, and their other basic financial goals, it is important that mutual fund disclosure is effective. Fund investors, including those who invest through defined contribution plans, should receive clear, concise, and meaningful disclosure about key fund information.

This is not just a matter of clearer writing, but also of clarifying our regulations concerning mutual fund fees and expenses. So the Commission is conducting a review of mutual fund fees and expenses, and the disclosure of these costs to investors. That review includes an examination of the $12 billion that investors now pay each year in Rule 12b-1 fees.

With the same objectives in mind, the SEC has intensified its focus on "soft dollars." Soft dollar arrangements involve a money manager's obtaining products or services, in addition to the execution of securities transactions, from or through a broker-dealer in exchange for the money manager's directing client brokerage transactions to the broker-dealer. In 2006, the Commission acted unanimously to publish interpretive guidance that clarifies that money managers may only use soft dollars to pay for eligible brokerage and research. In addition, the staff is now examining the adequacy of current disclosure for soft dollars.

Also, importantly, we are preparing for the Commission's consideration a mutual fund disclosure reform initiative. Today, I will outline this initiative and the ways in which it could prove to be helpful in the defined contribution plan marketplace.

Background on SEC's Mutual Fund Disclosure Reform Initiative

In recent years, numerous commentators have suggested that investment information that is central to an investment decision should be provided in a streamlined document with other more detailed information provided elsewhere. Furthermore, recent investor surveys indicate that investors prefer to receive information in concise user-friendly formats.

To gather perspectives from the public, in June 2006 the Commission held a Roundtable on interactive data and mutual fund disclosure reform issues. At the Roundtable, representatives from investor groups, the mutual fund industry, analysts, and others discussed how the Commission could change the mutual fund disclosure framework so that investors would be provided with better information.

Significant discussion at the Roundtable concerned the importance of providing mutual fund investors with access to key fund data in a shorter, more easily understandable format. The participants focused on the importance of providing mutual fund investors with shorter disclosure documents, containing key information, with more detailed disclosure documents available to investors and others who choose to review additional information. Roundtable participants identified the most important information that investors are likely to need to make an investment decision such as information about a mutual fund's fees and investment objectives and strategies, risks and performance.

We have also benefited from the work of a mutual fund task force organized by NASD. This task force concluded that investors would benefit from the creation of a "profile plus" document that would be available on the Internet and would include, among other things, basic information about a fund's investment strategies, risks, and total costs, with hyperlinks to additional information in the fund's prospectus.

Framework for Mutual Fund Disclosure Reform

The Commission is examining ways to reform the mutual fund disclosure framework. The goal of this examination is to find the best way to get investors a concise summary document containing key information about a fund described in plain English and in a standardized order. The key information contained in a concise mutual fund summary potentially could include a fund's fees and investment objectives and strategies, risks, and performance.

This reform initiative is intended to provide investors with information that is easier to use and more readily accessible while retaining the comprehensive quality of the information available today. This should help investors who are overwhelmed by the choices among funds, which are too often described in lengthy and legalistic prospectuses. A concise mutual fund summary could enable investors to access readily key information that is important to an informed investment decision, including information about fund fees.

If the Commission determines to propose a reformed mutual fund disclosure framework, I am hopeful that we will receive helpful public comment on the utility of the proposed approach.

Use in the Defined Contribution Plan Market

As the staff works to develop a reform initiative, we do so with a view toward making it useful for all fund investors, including those in defined contribution plans. Along these lines, my staff and I have been working with the Employee Benefits Security Administration (EBSA) of the Department of Labor. We are keeping EBSA apprised of our progress on the mutual fund disclosure reform initiative. We also have been discussing how a concise mutual fund summary could dovetail with EBSA's efforts in the defined contribution plan market. Given that just over half of defined contribution plan assets are invested in mutual funds, utilization of a concise mutual fund summary to provide clear disclosure about fund fees, investment objectives and strategies, risks, and performance could greatly benefit defined contribution plan investors. Our cooperative efforts should make it easier for Americans to understand the expenses they are being charged in connection with their investments, and the returns they are actually getting compared to an appropriate index. The work with EBSA has been helpful, cooperative, and mutually beneficial. My staff and I will continue to work with Assistant Secretary Campbell and the EBSA as we move forward on mutual fund disclosure reform.

Conclusion

In conclusion, the Commission supports the goal of providing clear, concise, meaningful disclosure to fund investors, including those investors that invest through defined contribution plans. As a greater percentage of Americans invest for retirement through mutual funds included in employer-sponsored defined contribution plans, it is essential that defined contribution plan investors be provided information that enables them to manage and evaluate their investments and understand the costs associated with them.

The Commission expects to consider proposal of the revised mutual fund disclosure reform framework in the near future, and the staff will continue to work with EBSA. Thank you for this opportunity to appear before the Committee, and I would be happy to answer any questions you may have.

Mr. MCDERMOTT. Thank you very much for your testimony, Mr. Donohue.

Ms. Bovbjerg?

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

Ms. BOVBJERG. Thank you, sir, Mr. Chairman, Mr. McCrery, thank you so much for inviting me here today to speak about the importance of 401(k) fee information and providing it to plan sponsors and participants. Plan sponsors, as fiduciaries, need the expense information necessary to make plan design and administration choices that are in the best interest of the participants. For participants, information about the fees being charged is important if individuals are indeed to be responsible for making wise decisions about their accounts.

I will speak first today about what information plan sponsors need, then discuss the information most necessary for participants. My statement is drawn primarily from our work last year on 401(k) fees.

Plan sponsors need a broad range of expense information, including fees, to adequately fulfill their fiduciary duties. ERISA, the law governing employer pension plans, requires that sponsors evaluate fees for reasonableness. While sponsors likely know what fees are associated with the investment options they offer to plan participants, they know less about fees embedded in the costs associated with the outside vendors that many hire to perform plan services. Specifically, as we noted in our prior work, plan sponsors may not have information they need on business arrangements among these outside service providers. Such arrangements, including revenue sharing, can represent hidden fees and could embody conflicts of interest negatively affecting plan participants. We have made recommendations to require plan service providers to offer sponsors information of this nature.

In our work with the pension industry, sponsor representatives and the Department of Labor, we have observed general agreement that sponsors should obtain such information. However, you should be aware that there is disagreement among pension professionals as to how much sponsors need to know about the so-called bundled arrangements, which are aggregations of services. Some feel that breaking down these consolidated fees into their component parts would raise plan costs and not provide particularly useful information. Others believe that not providing a break-out of such services and their costs would hide information from sponsors. However cost and fee information is provided, we believe fundamentally that it should be offered clearly and in a consistent way so sponsors can assure themselves, plan participants, and ultimately the Department of Labor that plan costs are reasonable.

But let me turn now to what participants need to know. Although most participants are responsible for directing the investment of their 401(k) accounts, few know what they pay in fees or even if they pay fees at all according to an AARP survey and this can be costly. Over a 20-year period, as Mr. McDermott said earlier, a 1 percentage point fee difference can reduce retirement savings by 17 percent, so it is clear that participants need basic fee information. What is not so clear is what information is the most relevant.

Most would agree that participants 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 would meet this need in most instances. Participants may also benefit from information on other types of fees, for example, annual fees or fees charged on a per transaction basis. Industry professionals we contacted also suggest that additional investment-specific fees might usefully be disclosed including sales charges, surrender charges, and so-called wrap fees. Some also suggest that participants receive information on returns net of fees to encourage them to consider fees in the context of an overall investment return rather than focusing on fee levels alone.

However, even more so than for sponsors, keeping the information simple and consistent is important if participants are to read and make use of it. In prior work, we found that certain practices help people understand complicated information. The use of simple language, straightforward and attractive lay-out, brevity and multiple means of distribution are all key to documents the general public will obtain, read, and comprehend. The format content and means of conveying 401(k) fee information will be crucial to achieving not just disclosure, but also improved participant understanding.

In conclusion, 401(k) sponsors and participants both need better and more consistent information on 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 savings 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 welcome your questions.

[The prepared statement of Ms. Bovbjerg follows:]

United States Government Accountability Office

GAO

Testimony before the Committee on Ways and Means, House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EDT
Tuesday, October 30, 2007

PRIVATE PENSIONS

Information That Sponsors and Participants Need to Understand 401(k) Plan Fees

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

GAO
Accountability * Integrity * Reliability

GAO-08-222T

GAO
Accountability Integrity Reliability

Highlights

Highlights of GAO-08-222T, a testimony before the Committee on Ways and Means, House of Representatives

October 30, 2007

PRIVATE PENSIONS

Information That Sponsors and Participants Need to Understand 401(k) Plan Fees

Why GAO Did This Study

Employers are increasingly moving away from traditional pension plans to what has become the most dominant and fastest growing type of plan, the 401(k). For 401(k) plan sponsors, understanding the fees being charged helps fulfill their fiduciary responsibility to act in the best interest of plan participants. Participants should consider fees as well as the historical performance and investment risk for each plan option when investing in a 401(k) plan because fees can significantly decrease retirement savings over the course of a career.

GAO's prior work found that information on 401(k) fees is limited. GAO previously made recommendations to both Congress and the Department of Labor (Labor) on ways to improve the disclosure of fee information to plan participants and sponsors and reporting of fee information by sponsors to Labor. 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 on 401(k) plan fees that (1) sponsors need to carry out their responsibilities to the plan and (2) plan participants need to make informed investment decisions. To complete this statement, GAO relied on previous work and additional information from Labor and industry professionals regarding information about plan fees.

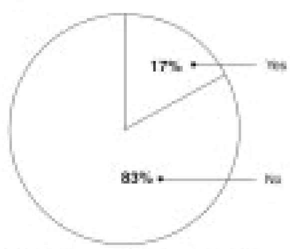
To view the full product, including the scope and methodology, click on GAO-08-222T. For more information, contact Barbara D. Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

What GAO Found

Information on 401(k) plan fee disclosure serves different functions for plan sponsors and participants. Plan sponsors need to understand a broad range of information on expenses associated with their plans to fulfill their fiduciary responsibilities. Sponsors need information on expenses associated with the investment options that they offer to participants and the providers they hire to perform plan services. Such information would help them meet their fiduciary duty to determine if expenses are reasonable for the services provided. In addition, sponsors also need to understand the implication of certain business arrangements between service providers, such as revenue sharing. Despite some disagreements about how much information is needed, industry professionals have made various suggestions to help plan sponsors collect meaningful information on expenses. Labor has also undertaken a number of activities related to the information on plan fees that sponsors should consider.

Participants need fee information to make informed decisions about their investments—primarily, whether to contribute to the plan and how to allocate their contributions among the investment options the plan sponsor has selected. However, many participants are not aware that they pay any fees, and those who are may not know how much they are paying. Most industry professionals agree that information about an investment option's relative risk, its historic performance, and the associated fees is fundamental for plan participants. Some industry professionals also believe that other fees that are also charged to participants should be understood, so that participants can clearly see the effect these fees can have on their account balances.

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, developed and deployed by Knowledge Networks, July 2007

Mr. Chairman and Members of the Committee:

I am pleased to discuss the information that sponsors and participants need to better understand the fees associated with their 401(k) plans. Named after section 401(k) of the Internal Revenue Code, 401(k) plans are private sector pension plans that typically allow workers to save for retirement by diverting a portion of their pretax income into an investment account that can grow tax-free until withdrawn in retirement. Over the past two decades there has been a noticeable shift in the types of plans employers are offering employees. Employers are increasingly moving away from traditional defined benefit plans to what has become the most dominant and fastest growing type of defined contribution plan, the 401(k).[1] As workers accrue earnings on their investments, they also pay a number of fees, including expenses, commissions, or other charges associated with a 401(k) plan.

For plan sponsors, understanding their expenses helps fulfill their fiduciary responsibility to act in the best interest of plan participants. Given this responsibility and the potentially large impact on an individual's account balance over time, it is important that both plan sponsors, typically the employer, and participants, as investors, receive and understand the fee information necessary to make informed decisions. 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. The Department of Labor (Labor) is currently finalizing regulations on the disclosure of fees to participants, and several bills have been introduced to improve such disclosure. These efforts have generated debate about the type of fee information sponsors and participants may need, and the amount and format of fee information that should be disclosed. As Congress considers these issues, you asked us to describe information sponsors and participants need about fees. My remarks today will focus on the information on fees that (1) sponsors need to carry out their responsibilities to the plan and (2) plan participants need to make informed investment decisions.

[1] Defined benefit plans, sometimes referred to as traditional pension plans, generally provide a fixed level of monthly retirement income that is based on salary, years of service, and age at retirement regardless of how the plan's investments perform. In contrast, benefits from defined contribution plans are based on the contributions to and the performance of the investments in individual accounts, which may fluctuate in value.

To describe the fee information needed by 401(k) plan sponsors and participants, 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 sponsors and participants, and Labor's oversight of fees.[1] We also used information from Labor and from industry professionals on the subject of fee disclosure to plan sponsors. We conducted our review in October 2007 in accordance with generally accepted government auditing standards.

In summary, plan sponsors need to understand a broad range of information on expenses associated with their 401(k) plans to fulfill their fiduciary responsibilities. For example, sponsors need information on expenses associated with the investment options that they offer to participants and the providers they hire to perform plan services. Such information would help them meet their fiduciary duty to determine if expenses are reasonable for the services provided. In addition, sponsors need to understand the implication of certain business arrangements between service providers, such as revenue sharing. While industry professionals might agree about some of the information that sponsors need, they disagree about how much information is needed about individual expense components when a package of plan services, known as a "bundled" arrangement, is sold to a sponsor for a single price. Despite this disagreement, industry professionals have made various suggestions to help plan sponsors collect meaningful information on expenses. Labor has also undertaken a number of activities related to the information on plan expenses that sponsors should consider.

Participants need fee information to make informed decisions about their investments—primarily, whether to contribute to the plan and how to allocate their contributions among the investment options the plan sponsor has selected. To make informed decisions, participants need to be made aware of an investment option's relative risk, its historic performance, and the fees they pay. However, many participants are not aware that they pay any fees, and of those who are, most may not know how much they are paying. Most industry professionals agree that information about investment fees, such as the expense ratio—a fund's operating fees as a percentage of its assets—is fundamental for plan

[1] 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.: Nov. 16, 2006).

participants. Some industry professionals also believe that other fees that are also charged to participants should be understood so that participants can clearly see the effect these fees can have on their account balances.

Background

Roughly half of all workers participate in an employer-sponsored retirement, or pension, plan. Private sector pension plans are classified as either defined benefit or defined contribution plans. Defined benefit plans promise to provide, generally, a fixed level of monthly retirement income that is based on salary, years of service, and age at retirement, regardless of how the plan's investments perform. In contrast, benefits from defined contribution plans are based on the contributions to and the performance of the investments in individual accounts, which may fluctuate in value.

The Employee Retirement Income Security Act of 1974 (ERISA) [3] 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.[4] 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.[5] 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 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

[3] 29 U.S.C. §§ 1001-1461.

[4] 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).

[5] 29 U.S.C. § 1002(21).

- ensuring that the services provided to their plan are necessary and that the cost of those services is reasonable.

Plan sponsors may 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. To better enable the agency to effectively oversee 401(k) plan fees, we recommended in November 2006 that the Secretary of Labor should require plan sponsors to report to Labor a summary of all fees that are paid out of plan assets or by participants. This summary should list fees by type, particularly investment fees that are being indirectly incurred by participants.

In addition to receiving information about investment fees, sponsors may receive information about expenses for administration and other aspects of plan operations. Sponsors can also have providers fill out the Form 5500, which ultimately gets filed with Labor,[6] and includes information about the financial condition and operation of their plans. Generally, information on 401(k) expenses is reported on two sections of the Form 5500, Schedule A and Schedule C.[7] However, our November 2006 study reported that the form is of little use to plan sponsors and others in terms of understanding the cost of a plan.[8]

While plan sponsors may receive information on investment and other fees, they may not be receiving information on certain relevant business arrangements. In November 2006, we reported that several opportunities

[6] 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 information about 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.

[7] 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.

[8] Labor's ERISA Advisory Council Working Group on Plan Fees and Reporting on Form 5500 came to this conclusion, finding 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.

exist for such 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. Service providers may be steering plan sponsors toward investment products or services in which they have a direct business interest themselves without disclosing such arrangements. 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 also recommended that Congress consider amending ERISA to require that service providers disclose to plan sponsors the compensation that providers receive from other service providers.

In our prior 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. 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 buying or selling interests in such alternatives.[5] 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,

[5] Section 404(c) of ERISA 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).

according to industry professionals. 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 that facilitates comparison. However, most 401(k) investment options have expense ratios that are provided in prospectuses or fund profiles and can be compared; based on industry data, expenses for the majority of 401(k) assets, which are in investment options such as mutual funds, can be expressed as an expense ratio.

Sponsors Must Consider a Broad Range of Information to Fulfill Their Fiduciary Responsibilities

Plan sponsors, as fiduciaries, must consider plan fee information related to a broad range of functions. According to Labor, ERISA requires that sponsors evaluate fee information associated with the investment options offered to participants and the providers they hire to perform plan services and consider the reasonableness of the expenses charged by the various providers of services to the plan. In addition, the sponsor must understand information concerning certain arrangements, such as when a service provider receives some share of its revenue from a third party. While industry professionals might agree about some of the information that sponsors need, they disagree about how much information is needed about individual expense components when a package of plan services, known as a bundled arrangement, is sold to a sponsor for a single price. Some pension plan associations and practitioners have made various suggestions to help plan sponsors collect meaningful information on expenses. Labor has also undertaken a number of activities related to the information on plan expenses that sponsors should consider.

Sponsors Need Information to Evaluate Fees and Expenses Associated with Investment Options and Plan Services

In order to carry out their duties, plan sponsors have an obligation under ERISA to prudently select and monitor plan 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 need to monitor the fees and expenses associated with the plan's investment options and the services provided by outside vendors, including any revenue sharing arrangements, to determine whether the expenses 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,[10] 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.

In our prior work, we noted that plan sponsors may not have information on arrangements among service providers that, according to Labor officials, could steer plan sponsors toward offering investment options that benefit service providers but may not be in the best interest of participants. For example, the Securities and Exchange Commission (SEC) released a report in May 2005 that raised questions about whether some pension consultants are fully disclosing potential conflicts of interest that may affect the objectivity of the advice.[11] In addition, specific fees that are considered to be "hidden" may mask the existence of a conflict of interest. Hidden fees are usually related to business arrangements where one service provider to a 401(k) plan pays a third-party provider for services, such as record keeping, but does not disclose this compensation to the plan sponsor. The problem with hidden fees is not how much is being paid to the service provider, but with knowing what entity is

[10] Float revenue is revenue earned from the short-term investment of plan assets.

[11] U.S. Securities and Exchange Commission, Office of Compliance Inspections and Examinations, *Staff Report Concerning Examinations of Select Pension Consultants*, (Washington, D.C.: May 2005).

receiving the compensation and whether or not the compensation fairly represents the value of the service being rendered.

While there is general agreement that understanding the fees and expenses associated with a plan's services is an important part of a fiduciary's responsibility, pension professionals disagree about how much information is needed about the expense components of bundled fee arrangements. One representative speaking on behalf of five industry associations stated he did not believe that the requirement to "unbundle" bundled services and provide individual costs in many detailed categories was particularly helpful because the information provided would not be very meaningful and the costs of providing this information would ultimately be passed on to plan participants through higher administrative fees. He also raised concerns about how a service provider would disclose component costs for services that are not offered outside a bundled contract. In addition, he said that posting such information could force public disclosure of proprietary information regarding contracts between service providers and plan sponsors. Finally, he stated that as long as they are fully informed of the services being provided, many plan sponsors might prefer reviewing aggregate costs so that they can compare and evaluate whether the overall fees are reasonable without analyzing each itemized fee.

On the other hand, a representative of another pension association contended that it is possible with very little cost to develop an allocation methodology to provide a reasonable breakdown of fees for plan services. He believes that not disclosing component pricing provides a competitive advantage, enabling bundled providers to tell plan sponsors that they can offer certain retirement plan services for free—when fees are deducted from investment returns—while unbundled providers are required to disclose the fees for the same services. He further stated that any disclosure requirements should apply uniformly to all service providers. In his view this would allow plan fiduciaries to assess the reasonableness of fees by comparison and thereby allow fiduciaries to determine whether certain services are needed, which could lead to lower fees.

Plan Sponsors Need to Collect and Evaluate Meaningful Information on Expenses

Industry professionals have suggested that, before hiring a service provider or adding investment options to the plan's menu, plan sponsors should obtain complete fee information, including information concerning arrangements in which a service provider receives some share of its revenue from a third party. Pension plan associations and practitioners have made various suggestions to help plan sponsors collect meaningful information on expenses.

In 2004 the ERISA Advisory Council on Employee Welfare and Pension Benefit Plans created a Working Group to study retirement plan investment management fees and expenses as they were currently reported to Labor.[12] In addition to issues related to annual reporting, the Working Group was also interested in determining whether plan sponsors currently receive adequate data from the service providers in order to both understand and report fees. In its final report, the Working Group made the following recommendations, among others, in an effort to further educate plan sponsors and fiduciaries about plan fees:[13]

- Plan sponsors should avoid entering transactions with vendors who refuse to disclose the amount and sources of all fees and compensation received in connection with plan.
- Plan sponsors should require plan providers to provide a detailed written analysis of all fees and compensation (whether directly or indirectly) to be received for its services to the plan prior to retention.
- Plan sponsors should obtain all information on fees and expenses as well as revenue sharing arrangements with each investment option. Plan sponsors should also determine the availability of other mutual funds or share classes within a mutual fund with lower revenue sharing arrangements prior to selecting an investment option.
- Plan sponsors should require vendors to provide annual written statements with respect to all compensation, both direct and indirect, received by the provider in connection with its services to the plan.

[12] Section 512 of ERISA provides for the establishment of an Advisory Council on Employee Welfare and Pension Benefit Plans. The duties of the council are to advise the Secretary and submit recommendations regarding the Secretary's functions under ERISA. The council consists of 15 members appointed by the Secretary of Labor. Three members are representatives of employee organizations; three members are representatives of employers; there is one representative each from the fields of insurance, corporate trust, actuarial counseling, investment counseling, investment management, and accounting; and three members are representatives of the general public. 29 U.S.C. § 1142.

[13] *Final Report of the 2004 ERISA Advisory Council Working Group, Health and Welfare Form 5500 Requirements* (Nov. 10, 2004).

- Plan sponsors need to be aware that with asset-based fees, fees can grow just as the size of the asset pool grows, regardless of whether any additional services are provided by the vendor, and as a result, asset-based fees should be monitored periodically.

- Plan sponsors should calculate the total plan costs annually.

More recently in 2007, one witness before the ERISA Advisory Council recommended further that plan sponsors should evaluate fees associated with three categories of services:[14]

- Net investment expenses would not only include investment expenses, such as the expense ratio of a mutual fund, but would also subtract any fees or commissions paid to a broker, consultant, or advisor for services in the categories below.

- Administrative expenses would include specific charges for operational services, such as record keeping, administration, compliance, and communication, as well as revenue sharing or other payments from investments.

- Advisory expenses would include amounts paid directly by the plan to consultants, advisors, or brokers, as well as indirect payments from sources such as investments or related companies.

In addition, some industry professionals believe that plan sponsors, as they monitor investment alternatives, should review investment alternative results against appropriate benchmarks and compare their plans' options to competing funds with similar investment goals.[15] A benchmark is used to compare specific investment results with that of the market or economy. Industry professionals also noted that although there are

[14] Written Comments of C. Frederick Reish, Reish Luftman Reicher & Cohen, for Testimony before the 2007 U.S. Department of Labor Advisory Council on Employee Welfare and Pension Benefits Plans Working Group on Fiduciary Responsibilities Update and Revenue Sharing Practices, (Sept. 20, 2007).

[15] Although some industry professionals believe that participants should be provided comparative benchmarks for their investment options, not all industry professionals agreed. Most industry professionals we consulted believed that benchmarks would be more useful for plan sponsors than for participants. Since plan participants do not have any control over the investment options offered in a plan, industry professionals 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.

appropriate benchmarks for mutual funds, benchmarks are not as readily available for other types of investment products. According to one industry professional that we spoke with, plan sponsors do not have good benchmarks to assess the reasonableness of investment options' expense ratios. Only limited information is available, and a national database of funds and their expense ratios does not exist. He further stated that without such a source, selecting which funds constitute a meaningful comparison set is not an easy task, and may be open to interpretation. Disclosure encourages price competition, but in his opinion, because of the lack of available information, the 401(k) market is relatively ineffective at fostering price competition.

Labor's Initiatives Related to 401(k) Plan Sponsors

Labor, in its comments on 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.[14] 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

[14] Statement of Bradford P. Campbell, Assistant Secretary of Labor, Before the Special Committee on Aging, U.S. Senate, Oct. 24, 2007.

involved in service arrangements. Other associations and entities continue to develop model fee disclosure forms for plan sponsors.

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.

Basic Fee Information Is Important for Participants to Make Informed Decisions

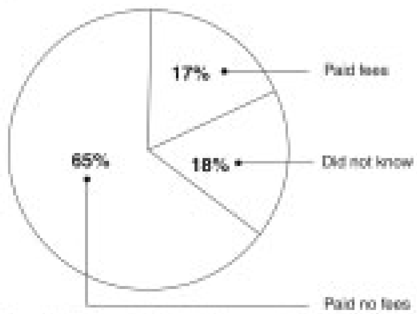
Before making informed decisions about their 401(k) plan investments, participants must first be made aware of the types of plan fees that they pay. For example, according to one nationwide survey, some participants do not even know that they pay plan fees. In 2006, we reported that investment fees constitute the majority of fees in 401(k) plans and are typically borne by participants. Most industry professionals agree that information about investment fees—such as the expense ratio, a fund's operating fees as a percentage of its assets—is fundamental for plan participants. Participants also need to be aware of other types of fees—such as record-keeping fees and redemption fees or surrender charges imposed for changing or selling investments—to gain a more complete understanding of all the fees that can affect their account balances. 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.

Participants May Not Be Aware of the Fee Information Needed to Make Informed Decisions

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 the most basic knowledge—that there are fees associated with their plan. When asked in a recent nationwide survey whether they pay any fees for the 401(k) plan, as figure 1 shows, 65 percent of 401(k) participants responded that they do not pay fees.[17] Seventeen percent said they do pay fees, and 18 percent stated that they do not know. When this same group was asked how much they pay in fees, as shown in figure 2, 83 percent reported not knowing.

Figure 1: Participants' Response to Survey Question on Awareness of Fees

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

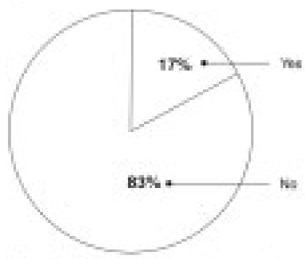


Source: AARP's Survey of 401(k) Participants' Awareness and Understanding of Fees, developed and deployed by Knowledge Networks, July 2007.

[17] AARP Knowledge Management, *401(k) Participants' Understanding and Awareness of Fees*, (Washington, D.C.: July 2007). AARP commissioned a nationally representative survey of 1,584 401(k) plan participants age 25 and older. The survey was fielded from June 8 through June 24, 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 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, developed and deployed by Knowledge Networks, July 2007.

Participants Need Information on Investment Fees

Although it is clear that participants require fee information to make informed decisions, it is not so clear what fee information is most relevant. In 2006, we reported that investment fees constitute the majority of fees in 401(k) plans and are typically borne by participants. Investment fees are, for example, fees charged by companies that manage a mutual fund for all services related to operating the fund. These fees pay for selecting a mutual fund's portfolio of securities and managing the fund; marketing the fund and compensating brokers who sell the fund; and providing other shareholder services, such as distributing the fund prospectus.[14] These fees are charged regardless of whether the mutual fund or other investment product, such as collective investment funds or group annuity contracts, is part of a 401(k) plan or purchased by individual investors in the retail

[14] 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.

market.[19] As such, the fees are usually different for each investment option available to participants in a 401(k) plan.

In our previous 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.[20] As mentioned earlier, there have been at least 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 not be required to produce prospectuses that include expense ratios, but according to industry professionals, most options have expense ratio equivalents that investment industry professionals can identify.

[19] Mutual funds that use brokers to sell shares may also impose a sales fee, or "load," when a fund is bought, transferred, or sold to compensate the broker. SEC does not limit the size of the sales load a fund may charge, but the Financial Industry Regulatory Authority does not permit exceeding 8.5 percent of the purchase price. A "front-end load" is incurred when a mutual fund is purchased and reduces the amount available to purchase fund shares. A "back-end load" is a fee that is charged when a mutual fund is sold or transferred. Back-end loads generally decrease over time in steps until they are eventually eliminated.

[20] 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.

Participants Also Need Information on Other Fees That Affect Their Account Balances

Industry professionals also believe that participants need information on other fees that are not included in the expense ratio but still affect their account balances. For example, annual fees or fees on a per transaction basis that can be deducted from account balances should be disclosed, such as administrative and record-keeping fees, participant loan origination fees, and annual loan charges.[21]

In addition, industry professionals also recommended that certain 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.[22]

Some industry professionals 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 to consider when directing their investments.

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

[21] 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.

[22] Wrap fees are for various expenses, such as sales commissions, administrative expenses, and/or recording keeping 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 record-keeping and administration.

the public understand Social Security information and on more effective disclosures for credit cards, we found that certain practices help people understand complicated information.[22] These practices include

- language—writing information in clear language,
- layout—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.

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 of 404(c) plans (but not all participant-directed plans) and the best way to do so. The initiative is intended to explore what steps might be taken to 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 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

[22] GAO, *Social Security Statements: Social Security Administration Should Better Evaluate Whether Workers Understand Their Statements*, GAO-05-192 (Washington, D.C.: Apr. 1, 2005); 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. 26, 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-97-19 (Washington, D.C.: Dec. 5, 1996).

compensation arrangements involved in 401(k) plans. Its brochure titled *A Look at 401(k) Plan Fees* is targeted to participants and beneficiaries of 401(k) plans who are responsible for directing their own investments.

Conclusions

Both 401(k) plan sponsors and participants need fee information in order to make the most informed decisions. 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. Requiring plan sponsors to report more complete information to Labor on fees—including those paid out of plan assets by participants—would put the agency in a better position to effectively oversee 401(k) plans and, in doing so, to protect an increasing number of participants. The mere act of requiring such information may actually promote competition among the entities that provide services to plans and possibly reduce the fees service providers charge.

For plan participants, given the voluminous amount of information that could be disclosed, 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.

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.

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. 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; Daniel F. Alspaugh; Monika R. Gomez; Matthew J. Saradjian; Susannah L. Compton; Craig H. Winslow; and Walter K. Vance.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "E-mail Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, DC 20548

To order by Phone:	Voice:	(202) 512-6000
	TDD:	(202) 512-2537
	Fax:	(202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, jarmong@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

Mr. MCDERMOTT. Thank you very much for your testimony. Without objection, I would like to enter into the record a statement by George Miller, the Chairman of the Education and Workforce Subcommittee.

[The prepared statement of Mr. Miller follows:]

Chairman Miller Statement on Ways and Means Committee Hearing on the "Appropriateness of Retirement Plan Fees"

Tuesday, October 30, 2007

***

I applaud Chairman Rangel for convening today's hearing on retirement plan fees, an issue with significant bearing on the retirement security of tens of millions of Americans.

Over the last three decades, the number of Americans with 401(k)-style retirement savings plans has skyrocketed. Today, 50 million workers have 401(k)-style plans. These plans were originally intended to supplement workers' main source of retirement income, not to supplant it. Yet today nearly two-thirds of private sector workers who have a pension have a 401(k) – *and only a 401(k).*

The median 401(k) account balance is now $19,000. For many retirees, that's not even enough to finance a single year of retirement. It's no surprise, then, that many Americans worry about how they will ever have enough savings to last them throughout their entire retirement.

Given this increasingly prominent role for 401(k) plans, it is critical that the plans provide the best possible deals for their participants. Unfortunately, many 401(k)-style plans charge hidden fees that can cut deeply into workers' retirement savings. And many plan participants do not have access to low-cost investment options – index funds – that can help them increase their retirement savings.

At an Education and Labor Committee hearing earlier this year, the Government Accountability Office testified that, under current law, weak disclosure requirements mean that workers lack critical information about fees they are paying. According to GAO, 80 percent of workers did not know that fees were being taken out of their accounts. Some of these fees may be reasonable and necessary. Yet without this information, employers and employees simply cannot shop around for the best deals.

The negative consequences of these hidden fees can be significant. According to GAO, a 1 percentage point increase in fees would cut retirement income by almost 20 percent over 20 years and by 30 percent over 30 years.

Earlier this year, I introduced legislation, the 401(k) Fair Disclosure for Retirement Security Act, that would require 401(k) plans to disclose in clear and simple terms all the fees that they are charging to plan participants. The legislation would require that 401(k) plans provide workers with key information on investment options and their risk, returns, and fees.

The legislation would also require employers to offer at least one low-cost index fund as an investment option for employees participating in 401(k) plans.

Studies have shown that index funds outperform an overwhelming majority of actively managed, often higher-cost funds. Plan participants don't have to choose to invest in the index fund if they don't want to, but they should be able to make that choice for themselves.

Finally, the legislation will assist employers by requiring that plan officials know the fees that will be charged before they contract for investment services. Service providers must disclose any potential conflicts of interest they may have.

After a lifetime of hard work, retirees ought not to have to sacrifice their standard of living. Helping workers to make better-informed decisions about their retirement options is a critical step towards increasing retirement security for America's workers.

Mr. MCDERMOTT. Mr. Campbell, I read the GAO highlights from last year in September and it says, “Congress should consider amending ERISA to require sponsors to disclose fee information on each 401(k) investment option in the plan to participants and to require that 401(k) service providers disclose plan sponsors for compensation providers received from other service providers. In addition, GAO recommends that Labor require plan sponsors to report a summary of all fees paid out of assets or by participants. Labor generally agreed with the findings and conclusion of the report.” Why has nothing been done at this point?

Mr. CAMPBELL. Well, actually, Mr. Chairman, I would take some issue with that, that nothing has been done. In fact, we have been quite active in this area for some time.

Mr. MCDERMOTT. When will your regulations be issued?

Mr. CAMPBELL. The first of the three regulations will be a final regulation within the next several weeks. That goes to disclosures to the public and to the government in the Form 5500. The proposed regulation for disclosures by service providers to plan fiduciaries is currently under review and will be promulgated within the next 2 months or so. The final regulation disclosures to participants, we completed a Request For Information (RFI) this summer to address those issues because those are some of the most technically difficult to address, and we will be issuing the proposed regulation this winter.

Mr. MCDERMOTT. Let me be a little more specific, do any of those regulations exempt the disclosure of fees collected by bundled plans?

Mr. CAMPBELL. No, this has been an issue that I think has become somewhat confused as two service providers with different business models look at our proposed regulation on the Form 5500 and offer different perspectives in the comment process. We believe—the interest in the Labor Department is ensuring that fiduciaries of plans have the information they need to carry out their duties under the law, to be able to assess the reasonableness of fees. In order to do that, we believe some of those fees clearly need to be broken out by bundle providers and others may not necessarily have to be. It is a question of which fees are appropriate to that understanding. With that respect, transaction-based fees I think would clearly need to be broken out, fees that are taken out of assets under management, finders’ fees and fees that would cause a material conflict of interest on the part of service providers with respect to third parties. Those are all areas that I think additional disclosure would be necessary regardless of the business model employed by a various service provider.

Mr. MCDERMOTT. Would that include fees paid by one provider, a manager, or received from another 401(k) plan that is being offered by the first provider, sort of—I do not know what you would call it, but some kind of return on investment, if I sell your stuff, do you give me something back?

Mr. CAMPBELL. It could well. The issue would be the nature of the fee itself and whether it is material to the plan to understand that relationship and how it would impact the fees that plan is paying or the services it is receiving. If, for example, it is receiving investment advice, the impartiality of that advice is a material consideration, so we the plan fiduciary would need to be able to assess whether there were material conflicts of interest by that advice provider.

Mr. MCDERMOTT. So, you are saying that revenue sharing would actually be covered in the things that are revealed?

Mr. CAMPBELL. Well, as I said, I think it would depend on the category of the fee in terms of how it is broken out. I am not trying to dodge your question. It unfortunately gets rather difficult in breaking out the specific types of fees, what they are called versus what they actually do. For our purposes, we would look at, as I said, issues like are they transaction-based, and are they coming out of the assets under management to determine whether those fees are material.

Mr. MCDERMOTT. Thank you. Mr. McCrery?

Mr. MCCRERY. Mr. Campbell, it is my understanding that the Department of Labor under ERISA has the responsibility for oversight of the fiduciary responsibilities of sponsors, is that correct?

Mr. CAMPBELL. Yes, sir.

Mr. MCCRERY. Can you just give us a thumbnail sketch of what the standards are that plan sponsors are supposed to adhere to?

Mr. CAMPBELL. Certainly, sir. With respect to selecting service providers, the plan fiduciaries are responsible and they are personally liable for losses that would result from a breach of these duties. They are responsible for ensuring that the plan is paying for only necessary and appropriate services and that these services are reasonable, that the contract is not of an excessive duration, that the amount being paid in relation to the services being received is appropriate. So, in the course of assessing that duty, it is incumbent on plan fiduciaries to go out and solicit information from various service providers to get a sense of how those fees relate to one another and whether the deal, so to speak, the offer they are looking at is appropriate and meets those duties. So, it is a process-oriented decision that goes into have you followed a prudent process in assessing those issues.

Mr. MCCRERY. How does the Department of Labor enforce that responsibility under ERISA?

Mr. CAMPBELL. Looking into the prudence of fees and the reasonableness of fees is one of the issues that we do conduct in our ongoing enforcement. In the last several years, we had something in the order of 350 cases that involved fee questions and recovered I believe something over $60 million for plans associated with those. But in part, it is because looking at this issue and the proliferation of new and different kinds of fees and the complexity of this marketplace, that we decided that education and outreach alone and enforcement alone were not sufficient, that what was necessary was an enhanced regulatory structure that would globally address these concerns and that is why we devised the three regulations that we are currently proposing. I think this particular issue that you are describing with disclosures by service providers to plans would be particularly addressed by our regulation that would essentially redefine what a reasonable contract is in order to qualify for the statutory exemption for a reasonable contract by specifying what disclosures are necessary, that they be in writing and these sorts of considerations.

Mr. MCCRERY. So, does the Department of Labor act as kind of the IRS over taxpayers, do you audit randomly plan sponsors and their plans?

Mr. CAMPBELL. We target our investigations by a variety of methods. Some of it we determine by looking at data filed with us on the Form 5500. That would be sort of analogous to reviewing the 10forties and looking for anomalies. We do that. We also, of course, get tips from participants, from plan fiduciaries, from service providers. We do not generally conduct purely random audits given the size of this universe. We have determined that we can be more effective in our enforcement efforts by targeting areas that we believe, based on what we have seen in our investigations, need additional interest. Sort of a proxy for that random audit is that when we do an investigation of a plan, we do not look solely at the one issue that brought us there. We tend to look more comprehensively at a variety of issues which gives us a similar effect while still targeting our enforcement resources.

Mr. MCCRERY. Did you say that the new regulations that you are developing, the three demonstration projects that you are undertaking now as well as any other re-formulation of regulations, will help you to audit and to discover instances of abuse?

Mr. CAMPBELL. Yes, sir, we will be collecting additional information about fees and expenses on the Schedule C of the Form 5500, which will assist us in that portion of targeting. It will also be in the 408(b)(2) regulation the disclosure by service providers to plans requiring written contracts with all the disclosures that we have been discussing here today, which will help us ensure that both service providers have complied and that fiduciaries have conducted their duties appropriately in evaluating that information.

Mr. MCCRERY. Mr. Chairman, I think it is very important that we support and, if necessary, supplement the efforts of DOL in enhancing their ability to ensure that plan sponsors are being good fiduciaries. The reason I say that is to me, you have got the responsibility of the plan sponsors to act as fiduciaries for the participants. Basically, we are talking about employers acting as fiduciaries for their employees. I get stuff in the mail, I have got mutual funds, I have got a Thrift savings plan. I have got an IRA that I had before I came to Congress, and I get stuff. I get these reams of stuff in the mail. Do I read them? Heck, no. Raise your hands, you out in the audience, if you read all that stuff you get in the mail. You do not either. Lie detector test right here. My point is that the plan sponsor, the employer, is much better able to look at all of these fees and the appropriateness of these fees than I can or a plan participant, an employee. They are just not going to do it, so I think DOL, based on what I have heard today, is headed in the right direction of enhancing their ability to monitor, to audit, and, if necessary, to impose fines punishment for plan sponsors that are not being good fiduciaries rather than our focusing micro on what plan participants need to know about conflicts of interest and this and that and bundling and unbundling. That is fine, but what I want to know as a plan participant, is what is my cost over the years going to be, is it going to be one point higher than Plan B or one point lower? Then I can weigh what is the history of performance of Plan A versus B, that is all I need to know. I do not need to know all this gobbledy gook, I will not look at it, I will not read it.

Mr. MCDERMOTT. Although I did not read it all, I did find a report that the Department of Labor studied this issue in 1997, they wrote a report and that was the end of it. So, we hope that this time we do not just wind up with a report sitting on the shelf, they actually do come out with some regulations. I think it is time for there to be action taken.

Mr. CAMPBELL. I assure you, Mr. Chairman, that is my intent. I cannot speak for what the Clinton Administration did or did not do.

Mr. MCDERMOTT. This is not a partisan issue. This is an issue that has been all across and everybody has reason to be concerned about it. Mr. Rangel?

Chairman RANGEL [presiding]. Well, it is not partisan unless you want to make it that.

Mr. CAMPBELL. Not at all, sir.

Chairman RANGEL. I agree with Mr. McCrery that just like insurance policies, all we want to know is are we getting a good deal and we do not want to know bad news. We want someone to kind of help us to be guided and believe that someone is taking care of. If it is not DOL or IRS, do not interfere, but at least allow us to know at the end of the day that the funds are being managed with a sense of fiduciary relationship. Having said that, I assume that all of you agree that the dramatic increase in these funds means that we should review how they are managed. Is there anyone that believes that we should just leave it alone and it will work its way out, work itself out? If we have to do something, have your departments and agencies ever come together to say that we have a problem in our country and make some contribution, as you definitely are this morning, to this panel in suggesting to us, as the GAO has, as to recommendations, as to what, if anything, we should be doing as the Legislative Branch of government? Mr. CAMPBELL?

Mr. CAMPBELL. I believe all three agencies here have been coordinating very closely on this issue to ensure that we are within our different statutes, working in complementary fashion to address these concerns.

Chairman RANGEL. You are doing that now?

Mr. CAMPBELL. Yes, sir.

Chairman RANGEL. All of you have had an opportunity to read the report of the GAO. Does that make any sense to the agencies that have managerial responsibilities of the funds? Have you taken any of the recommendations of the GAO into consideration?

Mr. CAMPBELL. Yes, sir, we have indeed. In fact, in the development of these three regulations, the GAO's work has been helpful to us as well as the other comments that we have received from the public. In our response to the report that Mr. McDermott mentioned, we said that we generally agreed with the findings of the GAO and that is correct, we do, and that is why we engaged in these projects, not in response to the GAO report but, in response to this problem that all of us are perceiving.

Chairman RANGEL. Well, have any of their recommendations made any sense to you so that you have adopted any of them?

Mr. CAMPBELL. Yes, sir, I believe that we have. I think in the proposed regulations that will come out, it will be clear where the areas of agreement have been, and I think the general thrust of their comments are consistent with the thrust of our regulations.

Chairman RANGEL. Well, absent—aside from the regulations, do you believe there is need for legislation by this Committee or any other Committee to assist you in monitoring how these funds are being managed? Do you think that the best thing we can do is to stay out, it or are there recommendations, legislative recommendations, you are prepared to make?

Mr. CAMPBELL. Well, at this point we believe that we have the statutory authority already to pursue these regulations and that taken together these three regulations do cover the waterfront of the issues here and that the regulatory process is well suited to resolving these concerns.

Chairman RANGEL. SEC agrees?

Mr. DONOHUE. Chairman Rangel, the SEC does agree. We have worked closely with the Department of Labor and as we have been working with our simplified disclosure reform project, we have been keeping in touch with the Department of Labor with an effort to see how we can be helpful to make sure that America's investors have access to the information that they need to make informed investment decisions when they have an opportunity to invest in products and mutual funds that are under our jurisdiction. We have had very good cooperation from the Department of Labor in that regard.

Chairman RANGEL. Does the GAO agree that the departments are treating your recommendations with some degree of urgency or the respect that you think it deserves?

Ms. BOVBJERG. I think that the Department of Labor is trying to address the three recipients of information that our three recommendations addressed. One was what information comes to the Department of Labor in the Form 5500; we made that recommendation to Labor and they are working on an enhanced disclosure for them to use in enforcing ERISA. The other two were recommendations to Congress to amend ERISA to improve information that sponsors can get from service providers and information that sponsors must provide to participants. When we were considering these recommendations, we thought very carefully before making a recommendation to Congress to amend a statute, and we did believe that there were questions about whether Labor's regulations would cover all plans, for example, not just 404(c) plans, and whether they would indeed have the authority to regulate non-fiduciary service providers. Hence, we put these as recommendations to Congress.

Chairman RANGEL. Let me take this opportunity to thank GAO for the good work that you continue to do. Tell me when did you say that this practice of regulations would be prepared so that we can take a look at it?

Mr. CAMPBELL. The final Form 5500 regulation will be released within the next several weeks. The proposed service provider disclosure regulation will be released within the next 2 months approximately and the participant level disclosures, we concluded a

RFI this summer and will be releasing a proposed regulation this winter.

Chairman RANGEL. To the GAO, having heard the broad jurisdiction that DOL claims to have, do you still think there is need for legislation outside of the regulations?

Ms. BOVBJERG. We stand by our recommendations. We think it would enhance the likelihood that these disclosures would survive without challenge.

Chairman RANGEL. Well, let's continue to work together. We look forward to the package that you are going to present to us, and I want to thank you, Mr. Chairman.

Mr. MCDERMOTT [presiding]. Mr. Herger? Mr. Lewis? Mr. Neal?

Mr. NEAL. Thank you, Mr. Chairman. Mr. Reeder, in your testimony, you cautioned against mandating overly detailed and lengthy disclosures. As you may know, the approach I have taken in my bill is a limited disclosure in major categories of cost to both workers and employers with the hope that increasing transparency can allow for more competition amongst providers. You suggested that any increase in cost should be weighed against benefits. Do you agree that improved performance and lower fees or expenses may be worth the cost if it is offered as I suggest?

Mr. REEDER. Yes, Mr. Neal, I do agree that increased disclosure will in fact be beneficial, and I think the approach of your bill is an interesting approach. I have to agree with my colleague from the Department of Labor that I think they can mandate that through regulations, however without an additional mandate from Congress.

Mr. NEAL. You also recommend that allowing State and local government plans to continue to oversee their retirement plans, including an effort to ferret out hidden fees. But, as one expert witness on panel three will tell us later, many are already forced to hire independent consultants to assist in this process, as noted by "The New York Times" yesterday as incidentally pretty good paying jobs apparently, would you agree that some limited and simple disclosure, either within the confines of the Tax Code or ERISA, could assist these local governments in getting the best deal from vendors?

Mr. REEDER. It is difficult for me to take a position contrary to many years of experience and jurisprudence with Congress mandating stuff on States, but traditionally ERISA and the Code have exempted State and local governments from particular requirements for reasons of federalism issues, but I think that is Congress' decision to make.

Mr. NEAL. Ms. Bovbjerg, in your testimony, you cite the recommendations of one expert before the ERISA Advisory Committee who suggested that companies need to evaluate fees based on three categories of services: investment, administrative, and third party expenses. This is similar to the disclosure I have sought in my legislation. Do you think that disclosure in these three broad groups is feasible by both bundled and unbundled service providers?

Ms. BOVBJERG. I would like to think that it is feasible. We are told by bundled providers that it would be costly and difficult for them to do that. We have not assessed how costly it would be, how difficult it would be. So, we are operating on the premise that it is feasible, but don't know at what cost.

Mr. NEAL. Okay. I had intended to go to Mr. CAMPBELL before you, but I was concerned my time would expire. Mr. Campbell, a similar question. Is it true that the proposed DOL regulation would have exempted bundled service providers from any additional disclosure provided by unbundled providers?

Mr. CAMPBELL. No, sir. I think, as I indicated before, there has been some dispute as to exactly what the proposed regulation would have required, and I think that is in some ways, the beauty of the notice of common process is the comments we received in response that help us analyze where we were clear and where we were not. As I indicated before, our concern is making sure that fiduciaries have the information they need and to the extent fees, such as transaction-based fees, fees that are coming out of assets under management, finder's fees, and material conflicts of interest are at play, those should be broken out regardless of the business model of the service provider.

Mr. NEAL. Well, if you heard that some bundled providers were already doing additional disclosure to some customers by segregating out major expenses, would you change your opinion of whether bundled providers can and should disclose more?

Mr. CAMPBELL. Well, again, sir, our concern is ensuring that the plans have the information they need to make appropriate decisions. It is not in my view the place of the Department of Labor to specify which business model is the correct one. As long as the information necessary is coming out, then the interests of the law have been served.

Mr. NEAL. Thank you, Mr. Chairman.

Mr. MCDERMOTT. Thank you. Mr. Johnson?

Mr. JOHNSON. Thank you, Mr. Chairman. Mr. Campbell, when I was Chairman of the Subcommittee with jurisdiction over ERISA, I often said Congress so loved to find benefit plans, they wrapped them in so much red tape, they strangled them to death and that is what has happened. You get a bunch of Federal regulation and defined benefit plans went by the board. Later testimony by another witness asserts that inappropriateness of DOL Field Assistance Bulletin 20033 regarding what they call extraordinary fees, and you probably are aware, being charged individually to participants, could you discuss why it makes sense to change or charge divorce decree costs to individuals rather than the plan because it was being charged to the plan, which is another big expense?

Mr. CAMPBELL. Yes, sir, the Field Assistance Bulletin you are referencing goes to the question of how plans account for the cost associated with the Qualified Domestic Relations Orders (QDRO). Essentially, in instances where couples divorce, there is a question as to which party receives which portions of pension funds and under what circumstances. Given that that is a cost that is directly linked to that particular participant and their unique situation, the Department determined that it was appropriate for plans to allocate the costs associated with administering that consent decree, that QDRO, to that particular participant rather than distributing that cost among all participants who would therefore bear the cost of the portion of them who had QDROs.

Mr. JOHNSON. No, I agree with you, I think you are right, and I am glad you made that statement. Could you tell me whether you think it is appropriate to disclose each cost associated with the bundled service provider or whether a single fee is appropriate or whether there is some middle ground on the issue?

Mr. CAMPBELL. Well, I think the answer to your question, as we have discussed here today, is that there is some middle ground that is appropriate. The concern that we have is ensuring that fiduciaries get the information they need to assess the reasonableness of fees and whether the services are necessary and appropriate. To the extent relevant fees need to be unbundled, that is what we would provide in our regulation. To the extent fees can be aggregated without disturbing the ability of fiduciaries to conduct that analysis, that is not an issue the Department would need to disturb. Again, our position is not to select a business model for service providers, but rather to ensure fiduciaries can carry out their duty.

Mr. JOHNSON. Yes, well, you remember we argued at length over whether or not to provide advice for the investors, and we more or less won that argument. But you guys are doing the right job over there.

Mr. Reeder, you talked about systemic problems with respect to disclosure of fees and said you didn't think it would warrant a new Federal program, and I happen to agree. Do you want to elaborate on that at all?

Mr. REEDER. I just want to reiterate the work that the Department of Labor is doing, and I do think that the Department of Labor does have the tools that it needs to provide regulations in this area, and we have been working with them very closely, especially on this package that is about to come out because we have an interest in the reporting of various items as well. But I think the Department of Labor has the tools that it needs.

Mr. JOHNSON. Thank you, sir. I yield back, Mr. Chairman. I will go on and talk some more.

[Laughter.]

Mr. MCDERMOTT. Mr. Doggett?

Mr. DOGGETT. Thank you and thank you for your testimony. Mr. Campbell, when the Department of Labor had an opportunity over a year ago to comment on the findings of the GAO, did it take exception or make objection to any of the findings of the GAO report?

Mr. CAMPBELL. I do not recall off the top of my head the exact language in our response. The issue on which we do have disagreement is the current statutory authority of the Department. We believe that section 505 of ERISA provides us general rulemaking authority to implement the provisions of section 404, which is the appropriate section.

Mr. DOGGETT. So, is that with the exception that you do not think we need to do anything in the Congress about this. As far as the specific kinds of disclosures that they thought were necessary for plan participants and plan sponsors, you agreed with their conclusions?

Mr. CAMPBELL. Again, in general, yes, sir.

Mr. DOGGETT. So, can we expect then that these regulations for plan participants that you eventually will get around to promulgating, will include addressing every recommendation GAO made, especially as it relates to bundled provider services?

Mr. CAMPBELL. I think the issue there is to bear in mind the distinction between disclosures to participants and what they should contain versus disclosures to plan fiduciaries.

Mr. DOGGETT. Yes, sir, and the GAO made recommendations concerning both and my question to you is as it relates specifically to plan participants, in these anticipated regulations, will you be addressing and attempting to implement every GAO recommendation, including those that relate to bundled services?

Mr. CAMPBELL. I will not want to say "every" until I re-read the GAO recommendations. However, sir, I think we are in general agreement as to the direction these participant disclosures——

Mr. DOGGETT. How about just every one that you did not object to last year when you had the opportunity to do it?

Mr. CAMPBELL. Well, again, sir, we did go through a request for information to provide additional information from the public, consumer groups, participants, plans, everyone. We need to evaluate the totality of that information in promulgating the final regulation. I can only say that again, we in the GAO, I think are on a very parallel path.

Mr. DOGGETT. As it relates to your statutory authority, which you do not want any more—you do not want any more statutory authority in this area—do you believe that you have statutory authority to require an option in each one of these plans that they have a low cost index fund for participants to choose?

Mr. CAMPBELL. No, sir, the statute does not specify.

Mr. DOGGETT. So, if we wanted to provide that option so that the 401(k) investment that employees and employers are making is not eaten up with excessive fees, you do not have authority to address that by providing the low index fund option?

Mr. CAMPBELL. No, sir, that would require a statutory change.

Mr. DOGGETT. With reference to the pace at which you are responding to this problem, which many of us consider to be a rather significant problem for employees, that if they were out, able to invest on their own in an index fund, they would be having a much bigger investment nest egg built up than with some of the plans where they do not have information and there are very high fees involved. As far as whether anything is different today for a plan sponsor or a plan participant anywhere in America from where we were when the GAO put this report out, nothing has changed as of today? I understand you are studying it and you have got RFPs and you have got proposed regulations, but everything today is in exactly the same situation that it was when the GAO report came out, right?

Mr. CAMPBELL. Yes, sir, that is correct.

Mr. DOGGETT. Okay, and as far as whether anything is to change for plan participants in the future, if I understood your previous answers, you say that you will get around to proposing regulations this winter. I gather as a practical matter, given the normal pace at the Department of Labor, that probably means February but in practice is March or April?

Mr. CAMPBELL. I believe on a regulatory agenda it does say February.

Mr. DOGGETT. Yes, sir, and so if you meet the deadlines the way other regulations in other areas are made, we are approaching the spring, though I suppose it is winter, and once you propose the regulations, that does not mean anything changes for plan participants either. It just means the process has started. Would you anticipate that before this Administration ends, that anything would actually be done that would change the experience of any worker or employee in America?

Mr. CAMPBELL. Absolutely, sir, if——

Mr. DOGGETT. On plan participant regulations?

Mr. CAMPBELL. Yes, sir, it is my intention to have a final regulation promulgated before the end of this Administration.

Mr. DOGGETT. When would be a likely time to expect that that would happen? Can you give us any date before January 2009?

Mr. CAMPBELL. I think it would be close to the end of 2008 given the requirements of the legislative process—excuse me, regulatory process.

Mr. DOGGETT. Finally, just let me say that I have the same experience that Mr. McCrery has. I get tons of paper and I do not read a lot of it, but the two things that I can read and compare with ease are net investment return and expense ratio, and it is that information and the opportunity to have the option if someone wants to include it as a part of their portfolio of a low index—of an index of low cost fund that I think we need to address. Thank you very much. Particularly thanks to the GAO for this important study that you have done in your testimony.

Mr. MCDERMOTT. Mr. Pomeroy?

Mr. POMEROY. Thank you, Mr. Chairman. I am very pleased that we are as a Committee looking at the whole area of pensions. Because we have not done that for a while, I am going to have my questions principally on defined benefits. So, I would ask the two Administration representatives whether the Administration believes defined benefit plans continue to offer something of value to plan participants in the marketplace?

Mr. REEDER. Absolutely, Mr. Pomeroy, we agree.

Mr. POMEROY. There is no Administration effort to press companies to either freeze pension plans or convert defined benefit pension plans into something other than defined benefit plans?

Mr. CAMPBELL. No, sir.

Mr. REEDER. No.

Mr. POMEROY. Excellent. I would ask the Department of Labor what is your take on the shape of pension—when I say "pension," I am talking about defined benefit plans; what is the shape of pension plan funding at the present time?

Mr. CAMPBELL. The shape of pension plan funding has improved in the past year for a combination of factors, including the deficits of the Pension Benefit Guarantee Corporation (PBGC), which have also improved. I think the implementation of the Pension Protection Act will further improve the funding status.

Mr. POMEROY. Well, let's not go there yet. We are over 100 percent funded on average and that the cries of insolvency that drove the Pension Protection Act have largely gone away in light of the mark to market accounting capturing higher stock market values and a higher interest rate environment, is not that correct?

Mr. CAMPBELL. I do not know that I would necessarily agree that they have gone away. I think the situation has——

Mr. POMEROY. No, what is the status of plan funding? The status of plan funding you said was improved. Indeed, in fact, there have been several studies, including the Millman study, that shows it is over 100 percent on average and that the solvency of plans is a substantially improved circumstance from 2 years ago, is that correct?

Mr. CAMPBELL. I believe that is correct, but the distinction I would make is the difference between funding at a particular point in time and the overall solvency of the system and whether in the long term it provides that same benefit.

Mr. POMEROY. Do you have a concern that rate shock, funding rate shock could precipitate a significant number of freezes of existing pension plans?

Mr. CAMPBELL. No, sir, I believe Congress struck the appropriate balance in the Pension Protection Act.

Mr. POMEROY. I am interested that you say that. Do you take issue then with the McKenzie study that showed 50 to 75 percent of anticipated freezes over the next 3 years?

Mr. CAMPBELL. I am afraid I have not reviewed that study, sir.

Mr. POMEROY. You have not reviewed the study? Interestingly enough, PBGD told us they had not assessed whether the Pension Protection Act requirements would likely cause plan freezing. It seems to me that this is something you would want to look at. Do you accept as a concern that rate shock could freeze plans?

Mr. CAMPBELL. Well, I certainly agree that that was a concern in the construction of the Pension Protection Act, which is why it was constructed as it was with a phased in sort of glide path to full funding.

Mr. POMEROY. Well, the glide path starts January 1st relative to many items of plan funding and would you then accept the proposition that it is important employers know what the new funding requirements will be?

Mr. CAMPBELL. Indeed, sir.

Mr. POMEROY. Are the funding requirements largely going to be determined upon regulations to be developed by Labor and Treasury?

Mr. REEDER. If it is okay with you, I will step in there. I think it is mostly Treasury's bailiwick, and we have been working hard since the enactment of PPA, and we have been issuing pretty regular guidance on the issues of funding beginning the day after the law was signed.

Mr. POMEROY. Well, I am interested to hear that because, as I understand it, there has yet to be final regulatory disposition of the following issues: the yield curve, asset smoothing rules, at risk rules, credit balance rules, the mortality table, lump sum valuation rules and benefit restrictions. Some of those have been preliminarily exposed, but none of them has been finally disposed. What is more important, something as critical as asset smoothing has yet to even be preliminarily addressed exposed. So, if you have been working on this from the beginning, you do not have much to show for heading it into late in the calendar year. Look, I am from Congress, we do not have much to show for the time either, but the problem is we are about to have a very significant development, and, Mr. Chairman, I am going to ask leave to continue this questioning if I might because I think it is very important we get to the bottom of this.

Mr. MCDERMOTT. We are going to have three votes in a very short period of time, and I would like to get a couple more Members in.

Mr. POMEROY. But this may be the only opportunity we have in forum to get from the Administration.

Mr. MCDERMOTT. Go ahead.

Mr. POMEROY. When is it anticipated that there will be proposed rules in the various areas I have just mentioned?

Mr. REEDER. Well, as you mentioned, nearly all of the rules do have—all the areas do have proposed rules out, and we have provided in those proposed rules that taxpayers can rely on those proposed rules as interpretations of the statue and with a minor correction also that on the yield curve, final guidance is out on the yield curve.

Mr. POMEROY. What kind of public comment was sought on the yield curve?

Mr. REEDER. Well, that is one of the problems with issuing final guidance is——

Mr. POMEROY. Yes, exactly right. There was none. The first word from the Treasury was the last word from the Treasury or yield curve, and the yield curve will substantially impact plan funding. Is it anticipated that asset smoothing will also be the first word and final word?

Mr. REEDER. No, that will come out in a proposed regulation.

Mr. POMEROY. Come in a proposed rule, so at what time will this period of comment run, how can it possibly be concluded by January 1st?

Mr. REEDER. It cannot. As Mr. Campbell pointed out, the regulatory process, because it requires input from the public, this will take more than the time that we have before it goes into effect.

Mr. POMEROY. Mr. Chairman, I raise these series of questions not to kind of poke partisan blame any direction whatsoever. I just think we need to take note as a Committee that plans have recovered in terms of the snapshot of their funding and that yet substantial new funding requirements are about to descend on plans as of January 1st, and they do not even know what the funding levels will be because the regulations have not been completed yet in critical areas. I believe that this weighs toward very much—begs Congress really to look at whether or not we want to give an extension before implementation of the Pension Protection Act in order not to have plans pushed into freezing their benefits—freezing their pensions. Thank you, Mr. Chairman.

Mr. MCDERMOTT. Thank you. We will come back to this issue. Mr. Ryan? No questions? Mr. Kind? Oh, excuse me, Ms. Tubbs Jones.

Ms. TUBBS JONES. Sorry, Mr. Kind. I sat down here for a long time waiting to ask questions. Let me try to be very quick and, Mr. Pomeroy, if you still want some more time, I will be glad to yield you some of mine at the end. In conjunction with the questions that my colleague was asking, Ms [continuing]. Pronounce your last name for me.

Ms. BOVBJERG. Bovbjerg.

Ms. TUBBS JONES. Bovbjerg.

Ms. BOVBJERG. Like "iceberg."

Ms. TUBBS JONES. Okay, what do plans and investors or employees really need to know to guide them through the situations or concerns that have been raised by my colleague, Mr. Pomeroy?

Ms. BOVBJERG. For defined benefit plans?

Ms. TUBBS JONES. Yes, ma'am.

Ms. BOVBJERG. Well, they will need to know how their funding status will be measured. I would like to think that if they are at 100 percent now, they probably do not have a lot to worry about under the Pension Protection Act, but they will need to know what sorts of interest rates they need to use and the yield curve.

Ms. TUBBS JONES. How will that affect them if they do not have that information?

Ms. BOVBJERG. It will be hard to plan ahead.

Mr. POMEROY. Will the gentle lady yield?

Ms. TUBBS JONES. I will yield.

Mr. POMEROY. Thank you very much for that because it gets to what our witness said. Actually, the new funding requirements will attach irrespective of whether they are 100 percent funded. There will be a category, yet to be finally defined, called at-risk that might be deemed to be less than 100 percent funded, and they are going to have higher requirements and higher requirements yet.

Ms. BOVBJERG. I was thinking about the at-risk plans status.

Mr. POMEROY. But even fully funded 100 percent funded plans are going to have substantially higher funding requirements under the Pension Protection Act and in an unforeseeable way because the final rules have yet to be developed.

Ms. TUBBS JONES. Are you done?

Mr. POMEROY. Yes.

Ms. TUBBS JONES. Okay. Let me ask—taking back some time that I have, it always seems that at a time when employees are at the risk of losing access to pensions, in my congressional district, I am looking at companies closing and saying, "Okay, here you have got $50,000, and I am going to send you back to school after you work 30 years." In this environment, it seems awful that it would be that now companies and plans do not have information that they really need to operate to help these poor folks who are getting $50,000 for a lifetime of work. Do you believe that the current law provides adequate information to enable employers and employees to make informed choices among plans? I am going to start with you, and I will probably get 2 seconds left from everybody else.

Ms. BOVBJERG. Well, in terms of 401(k)s——

Ms. TUBBS JONES. Yes.

Ms. BOVBJERG [continuing]. Where employees do have choice, it will depend on what kind of plan they are in and what kind of information the sponsor provides, but what we found was that it is just not uniform, that people do not always have the information they need, particularly with regard to fees. Now, we do want to say that fees are not the only thing, the only piece of information that a participant would need. You also want to know——

Ms. TUBBS JONES. If you will yield just for a moment, it may not be the only piece of information that they need, but it could be a significant factor in making the decision whether you choose one plan over another.

Ms. BOVBJERG. Yes, we agree, absolutely, and they are not all getting that information.

Ms. TUBBS JONES. Any other gentleman, any of you want to tackle any of the questions I have asked?

Mr. CAMPBELL. Well, I would just say that it is precisely because we believe both participants and plan fiduciaries need additional information that we embarked on these regulatory projects.

Ms. TUBBS JONES. That is wonderful that you say you embarked on the regulatory project, but if they do not have the information they need within a timely fashion, the fact that you embarked—the ship has already gone to sea.

Mr. CAMPBELL. We began these projects in order to get them moving as quickly as we can. They are well advanced. I can only pledge again that it is my desire——

Ms. TUBBS JONES. Do you need more employees to help you do it?

Mr. CAMPBELL. We have the staff necessary to carry out the process, it is just that, as I am sure you aware, there are legal requirements to the regulatory process, notice and comments, et cetera, that take time. We are doing it as expeditiously as we can.

Ms. TUBBS JONES. So, my last question, since I know I am almost out of time, when are we going to have them?

Mr. CAMPBELL. Well, again, we will have the final Form 5500 regulation disclosures to the public within the next several weeks. We will have a proposal on the——

Ms. TUBBS JONES. You know that is not an answer, the next several weeks, next year?

Mr. CAMPBELL. No, quite literally the final regulation will be published in the "Federal Register" within the next several weeks.

Ms. TUBBS JONES. Okay, there are 7 weeks left in this year. There are 8 weeks left to this year. Those eight could be included in several, so you are making a commitment to me and the public that we are going to have it before the end of the year?

Mr. CAMPBELL. Yes, ma'am.

Ms. TUBBS JONES. Okay. Thank you, Mr. Chairman.

Mr. MCDERMOTT. Mr. Kind?

Mr. KIND. Well, thank you, Mr. Chairman. I know we have got a vote pending so I am going to try to be brief. I want to thank our panelists for your testimony here today but also thank the Committee for having this hearing on a very important issue. I think we can all agree sitting here and stipulate that better transparency is what is going to drive competition in the fund market, which is good, but also hopefully better investment decisions too at the end of the day. But the key, and I think, Mr. CAMPBELL, you alluded to this in your earlier opening statement, is to not get too cumbersome or complicated or legalese, I think is the term you used, so that plan participants are not just glancing at it and throwing it away and not reading it and not really being informed with the decisions and whether we do that through rulemaking or the regulatory process, you are involved in the legislation I think is going to be the key to striking the right balance. But my question or my concern really, because it seems clear listening or reading through some of the written testimony and talking to a variety of people in regards to this hearing, is that what additional burden we ultimately end up with is going to be expenses ultimately passed on to the plan participants. My concern right now, because I have been working on this issue, is how do we simplify or make it easier for small businesses to be participating and to be offering a menu of retirement options too without driving them away? I do not know if that is a concern that Labor has been focused on as you move forward with your own regulatory scheme that you are coming up with but what can we do in order to make sure that small businesses still see this as a viable option, that we are not becoming too burdensome or too expensive for them to be able to offer these plans because I think that is kind of the great missing bulk of workers out there right now that we need to get into these plans and to be offering more options rather than driving them away. I think that is one of the concerns that I have that is shared with a variety of others. I do not know, Mr. CAMPBELL, if you want to address that or, Mr. Reeder, too if you have a thought on the subject?

Mr. CAMPBELL. Obviously, one of our concerns at the Labor Department is to increase the availability of plans and the adoption of plans by particularly small employers. We focus a lot of education and outreach on small employers and compliance assistance programs to help them better comply and reduce that burden. For example, in the Form 5500 filing regulation I have mentioned, there is a reduced filing burden on small employers, steps of that nature we are on an ongoing basis taking.

Mr. REEDER. I would just like to reiterate, our emphasis is on increasing the use of standardized plans that small employers can pull off the shelf and establish and maintain a very, very low cost.

Mr. KIND. Great, thank you, thank you all. Thank you, Mr. Chairman. I yield back.

Mr. MCDERMOTT. I am going to ask the panel, I am sorry for this interruption, but we do have three votes and we have 5 minutes left to get over and vote. We should be back some time close to 5 minutes to 12:00. If you could wait for us, there are still some Members who would like to question you, so for the moment I will hold the meeting in suspense.

[Recess.]

Mr. MCDERMOTT. The Committee will come back to order. Mr. Pascrell from New Jersey will inquire.

Mr. PASCRELL. Thank you, Mr. Chairman. I have a question, my first question is for Mr. Donohue. Mr. Donohue, you noted in your testimony that Americans invest over $3 trillion in defined contribution plans and over half of that amount is invested in mutual funds, is that correct?

Mr. DONOHUE. That is correct.

Mr. PASCRELL. What role do you think can the Securities and Exchange Commission (SEC) play in ensuring that Americans are making informed investments? I am going to ask you what do you think is an "informed investment"?

Mr. DONOHUE. I will start off by saying that we have an initiative underway that I discussed previously that is intended to assist investors, whether they are investors investing directly or investors who are investing indirectly through their 401(k)s to have information available to make informed choices about their investment needs and the choices that are available to them. This initiative we have been working in conjunction with the Department of Labor to see how this type of disclosure, this type of simplified information could be utilized in the 401(k) area also. So, it is something that is very, very important for investors. It is a top priority in my division.

Mr. PASCRELL. So, you have information available?

Mr. DONOHUE. The information that we are talking about is currently available but, as was noted previously, is included in rather lengthy documents that people wind up receiving. This is a very simplified form that we are contemplating, which is two or three pages long, and provides information about investment strategies, objectives, costs, expenses, and performance.

Mr. PASCRELL. Mr. Donohue, what do you consider to be an informed investment in your estimation?

Mr. DONOHUE. In my experience, an informed investment is someone making a choice, understanding what their investment goals are, appreciating the risks and returns that might be available from the investment choices they are making, taking into account appropriate diversification of their investments and seeking to really achieve their goals, understanding the attributes of those investments, including expenses.

Mr. PASCRELL. But you know yourself, Mr. Donohue, that as you say, most of the information that is available is multi-pages. The average citizen does not read it obviously. Ninety percent, 85 percent, 80 percent do not know what they are getting into in the first place, which does not say much about us, does it? It is like when you get to be 70 years of age, and you have to be prepared, if you have invested in certain plans, you have got to prepare to file and you have to know who to call. A lot of people are not prepared to make those decisions, and I really have some question about it.

But I want to ask the next question of Ms. Bovbjerg?

Ms. BOVBJERG. "Bovbjerg."

Mr. PASCRELL. Bovbjerg, I am sorry.

Ms. BOVBJERG. It is hard, there are a lot of consonants.

Mr. PASCRELL. Ms. Bovbjerg, we have responsibilities here, I just talked to the SEC, but the primary responsibilities are with the Labor Department of oversight and the Treasury Department. I want you to take a step back now because I know already Mr. Reeder said the Labor Department is best qualified to do this particular job of oversight, so I would imagine that we have had good oversight from the Labor Department on these issues, do they work together?

Ms. BOVBJERG. They do work together, and I understand that they have been working together on this particular issue. It sounds like you are familiar with some of our other reports where we have talked about the need to work together more closely, and that often, particularly with Labor and SEC, it has been an informal relationship.

Mr. PASCRELL. But you do not have any question that the major effort should be, oversight should be Labor not Treasury, why would it not be Treasury? Why would not the Treasury Department have the major responsibilities of guarding people's investments and the decisions they make about those investments, tell me?

Ms. BOVBJERG. Well, under ERISA, IRS is responsible for determining the tax qualification status of plans, and they want to see certain things from sponsors in order to assure themselves that the plans are tax qualified. Labor is really responsible for employer-sponsored plans and assuming that the employers are behaving as responsible fiduciaries and doing prudent things that are in the best interest of the participants. Labor has the primary responsibility for fiduciary enforcement.

Mr. PASCRELL. Well, Labor has been in front of us many times on many different issues and that is one of the things we talk about is whether they are fulfilling their obligations of oversight and what that means. So, Mr. CAMPBELL, if I may, according to your testimony, the number of active 401(k) plans has risen almost 500 percent since 1984 and has increased by 11.4 percent since 2000. To what do you attribute this great explosion in growth of 401 plans, 401(k) plans, what is your estimate?

Mr. CAMPBELL. I think there are a variety of factors that go to what plans suit the mutual needs of employers and workers. Defined benefit plans offer many very positive attributes, but they generally are not as portable for example so in a more mobile workforce, increasingly as we see workers with more than one career, more than one employer for workers, the 401(k) option may be more appropriate for some workers. Ultimately, our view is that both plans are very valuable, both basic designs, and it should be up to the employers and workers in a given industry sector to pick the plan that best works for them.

Mr. PASCRELL. Mr. Chairman, could I ask one more quick question, please?

Mr. MCDERMOTT. Well, we have kept them here waiting so.

Mr. PASCRELL. Okay, quick.

Mr. MCDERMOTT. Fine.

Mr. PASCRELL. Has Federal regulation, Mr. Campbell, kept pace with the explosion in the use of 401(k) plans in your estimation?

Mr. CAMPBELL. I believe that we have responded as changes are made and the three regulations we are doing in this area are an example of that.

Mr. PASCRELL. I thought you would say that. Thank you. Thank you, Mr. Chairman.

Mr. MCDERMOTT. Ms. Schwartz will inquire.

Ms. SCHWARTZ. Thank you, Mr. Chairman. Thank you for staying and thank you for a number of things from my colleagues on both sides of the aisle here, really saying to some extent very much the same thing, which is good and not so usual for us, and that is that we do believe that employees need more information and the question is how to get that to them in a way that is comprehensible and will make a difference in some of the choices they make and assure that with the continued growth of 401(k) plans and our interest in helping to make sure that people save, that Americans save. They are not saving enough, this is a great way for them to do it. But with the enormous growth, the recent growth, there are two areas that I think we are sort of zeroing in on as I hear from some of my colleagues.

I wanted to start first with the information. Ms. Bovbjerg, if you could just be a little more specific if you can about not only the kind of information that would get to employees, but I am interested in how an employee would even know what else is out there and how to really compare both what is being offered to them by their employer, but potentially what are other—what else might be out there that they might even ask about? One of my colleagues asked about index funds and whether that is offered or not, how would an employee even say to their employer, well, how do I compare this to what else might be offered in some other business or another employer situation, how do I compare what the average fees might be? If they just tell them exactly what is being offered, I believe it is very elaborate, how do they even know how to make some comparison or ask the questions?

Ms. BOVBJERG. Well, of course, it is difficult to compare fees for different types of investment vehicles because the investment vehicles themselves might be different.

Ms. SCHWARTZ. Is there an average? In the marketplace, is there some way to sort of average what the fees are in different kinds of offerings? Is there a way to do that that someone can say why are we paying above the industry average? If you are looking for more competition here, for more ways to make judgment, is there a way to do that?

Ms. BOVBJERG. There is probably a way to do almost anything but bench marking is really difficult in this area. There is not a lot of good information about what is being paid in fees. It would depend on the type of investment option you were looking at, but that is why we at GAO think it is important that, whatever is provided to people, it not only be simple,e but it be consistent. It is not just so you might compare to your neighbor's plan, that is not really what we were thinking about as much as instances where people move, people change employers. If they move from one employer to another, it would be helpful to them not to have to start all over to understand how the new employer is reporting fees.

Ms. SCHWARTZ. I think that is very important for us to look at consistencies so that there is that ability. How often do you think an employee should get this information, just when they enroll, annually, any time they ask? How often should an employee get this kind of information?

Ms. BOVBJERG. You want to trade off frequency with how burdensome it is on those providing the information. We have called for disclosures annually and at sign up, but you could do it a number of other ways.

Ms. SCHWARTZ. Is this a plan sponsor's responsibility to provide this information or is it one of the investment advisors, who provides this information? Then who would check to see that it is consistent and appropriate?

Ms. BOVBJERG. Well, it is fundamentally the plan sponsor's responsibility. They are the fiduciary. They are the employer, and so they are responsible for providing accurate information clearly under the law. Then it would be the Department of Labor's responsibility in almost any structure that we would set up for fee disclosure to assure that it is being done and that it is being done appropriately.

Ms. SCHWARTZ. Certainly if the employer were to re-negotiate the agreement they have, would they have to tell the employees about that even if it is not annual or at sign up because they have a contract potentially with the people who are the plan sponsors?

Ms. BOVBJERG. If it is a fee that affects the employee, yes, I think they should.

Ms. SCHWARTZ. So, that would be another moment when they might need to have to disclose that we just re-negotiated this contract and your fees are going up or they are changing in some way?

Ms. BOVBJERG. That is right. If we are expecting people to make decisions with their money, they need to know what their money is being used for.

Ms. SCHWARTZ. One other question, I do not know if you would know this or whether this would be Mr. Campbell, whether in fact is there a difference in terms of how much information is provided depending on how big the employer is? I would imagine that large employers have human resource departments, they have people who could give this information for a small employer who might be offering a 401(k), is that much harder for them to handle that fiduciary responsibility and does that prevent them from engaging in 401(k) plans, do you know?

Ms. BOVBJERG. There is a variety of fairly simple approaches to this that I believe Mr. Reeder referred to earlier that are particularly helpful to small business. When you think about disclosure, if you keep it simple, direct and narrow, I think everybody should be providing that information.

Ms. SCHWARTZ. One last question, if I may, for Mr. Campbell. You talked a little bit before about reviewing the Form 5500. Could you be any more explicit about how you could use that as a tool for enforcing fiduciary responsibility and being able to make sure, I think some of my colleagues talked about this, it is very difficult for individual employees to make some of these judgments. We want to get them information where they can be able to compare, but really the employer, the plan sponsor has enormous responsibility here to be making certain judgments, and the only one really looking over their shoulder is I guess the Department of Labor really and Treasury, so maybe between the two of you, I would think that many employees would be just trusting that somebody is watching and that the information they are getting from their employer is accurate and full disclosure. Can you speak to the specifics of how many times you have had to enforce or call on a plan sponsor who is not doing the job right? Can you give us any numbers on that, the number of people you had to shut down or change?

Mr. CAMPBELL. Sure. With respect to our overall enforcement efforts, in the last fiscal year, fiscal year '06, we had about $1.4 billion in total monetary results and about 106 criminal indictments that flowed from our investigations. I had said earlier that we have had somewhere in the order 350 cases in recent years that deals more specifically with fee issues and all of this together helped us come to the conclusion that a regulatory structure needed to be improved and expanded upon rather than solely relying on enforcement or solely relying on education and outreach.

Ms. SCHWARTZ. Well, that actually speaks to our—well, I know you got beat up a little bit earlier about not moving on regulation fast enough, and I think that certainly from my point of view, we need to see that move much more quickly to respond. That is a lot of complaints, a lot of concerns and with this enormous growth in this, we want to make sure that people have the information they need, and they are not being taken advantage of and have lots of savings at the end of the day, right?

Mr. CAMPBELL. Well, I can assure that is our goal as well, and we are moving as quickly as the regulatory process allows us to.

Ms. SCHWARTZ. Alright, and I think my time is up. Thank you, Mr. Chairman.

Mr. MCDERMOTT. I want to thank the panel for both your testimony and for being patient with our schedule here in the House. Thank you.

Mr. CAMPBELL. Thank you, sir.

Mr. MCDERMOTT. Our next panel is Mr. Burgess Thomasson, who is President and CEO of DailyAccess Corporation; Harold Jackson, who is the President and CEO of Buffalo Supply of Lafayette, Colorado; Allison Klausner, Assistant General counsel for Honeywell, she is the benefits coordinator for Honeywell; and Lew Minsky, who is the Senior Attorney for Florida Power & Light; and Paul Schott Stevens, who is President and CEO of Investment Company Institute. As I said before, your testimony will be entered into the record in full, and we would appreciate you making your comments within the 5-minute time limit. Mr. Thomasson?

STATEMENT OF BURGESS A. "TOMMY" THOMASSON, JR., PRESIDENT AND CEO, DAILYACCESS CORPORATION, MOBILE, ALABAMA, ON BEHALF OF THE AMERICAN SOCIETY OF PENSION PROFESSIONALS & ACTUARIES, AND THE COUNCIL OF INDEPENDENT 401(k) RECORDKEEPERS

Mr. THOMASSON. Thank you, Mr. Chairman, and Members of the Committee. My name is Tommy Thomasson, and I am the CEO of DailyAccess Corporation of Mobile, Alabama. My firm is the leading provider of retirement plan services to small businesses throughout the country. As an independent service provider, we support and actually practice full fee disclosure.

I currently serve as the chair of the Council of Independent 401(k) Recordkeepers or CIKR. 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 (ASPPA), which has thousands of members nationwide.

I am also here on behalf of the Small Business Council of America, which represents thousands of small businesses across the country.

ASPPA and CIKR strongly support the Committee's interest in shining a light on 401(k) fees. We are encouraged by the two currently pending fee disclosure bills in the House of Representatives, including a bill introduced earlier this month by Congressman Neal and cosponsored by Congressman Larson of this Committee. We support both bills' uniform application of new disclosure rules to all plan service providers, and we encourage you to stay on this path.

The 401(k) plan industry delivers investment and services to plan sponsors and their participants using two primary business models commonly known as bundled or unbundled. Generally, bundled providers are large financial services companies whose primary business is 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 non-proprietary investment alternatives. Bundled and unbundled providers have different business models, but for any company choosing a plan, the selection process is exactly the same. The company deals with just one vendor and one model is just as simple as the other.

Plan sponsors must follow prudent practices and procedures when they are evaluating service providers and investment options. This prudent evaluation should include an apples to apples comparison of services provided and the cost associated with those services. The only way to determine whether a fee for a service is reasonable is to compare it to a competitor's fee for that same service.

The retirement security of employees is completely dependent upon the businessowner's choice of retirement plan service provider. If the fees are unnecessarily high, the worker's retirement income will be severely impacted. It is imperative that the businessowner 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 so. While we appreciate DOL's interest in addressing fee disclosure, we do not believe that any exemption for a specific business model is in the best interest of plan sponsors or participants. Without uniform disclosure, plan sponsors will have to choose between a single price business model and a fully disclosed business model that will not permit them to appropriately evaluate competing provider services and fees. Knowing only the total cost will not allow plan sponsors 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 participants' account balances grow over time. Take a $1 million plan service 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, 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 tell plan sponsors that they can offer retirement plan services for free while independents 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). In reality, the cost of these "free" plan services are being shifted to participants in many cases without their knowledge.

The uniform disclosure of fees is the only way that plan sponsors can effectively evaluate the retirement plan they will offer to their workers. To show it can be done, attached to my written testimony is a sample of how uniform plan sponsor disclosure would look. By breaking down plan fees into only three simple categories: investment management, recordkeeping and administration, and selling cost and advisory fees, we believe plan sponsors will have the information they need to satisfy their ERISA duties.

The retirement system in our country is the best in the world and competition has fostered innovations and investment 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 through uniform disclosure of fees and services, American workers will have a better chance of building retirement assets and living the American dream.

Thank you again, and I look forward to your questions.

[The prepared statement of Mr. Thomasson follows:]

Statement by Tommy Thomasson, President/CEO of DailyAccess Corporation on behalf of ASPPA and CIKR

Comments Presented to the House Ways and Means Committee United States House of Representatives

Hearing on Disclosure of 401(k) and Other Self-Directed Account Pension Plan Fee and Expense Information

October 30, 2007

Chairman Rangel, Ranking Member McCrery, and distinguished members of the Committee, my name is Tommy Thomasson, President/CEO of DailyAccess Corporation. My company, based in Mobile, Alabama, provides retirement plan recordkeeping and administration services to thousands of 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), for which I currently serve as Chair, to testify on important issues relating to 401(k) plan fee disclosures.

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 70,000 plans covering 3 million participants holding in excess of $130 billion in assets.

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 are encouraged by the two currently pending fee disclosure bills, H.R. 3765, introduced earlier this month by this committee's Rep. Richard Neal (D-MA) and cosponsored by this committee's Rep John Larson (D-CT); and H.R. 3185, introduced by Rep. George Miller (D-CA), chairman of the House Education and Labor Committee. We support both bills' even-handed application of their new disclosure rules to all service plan providers, regardless of their structure, and we encourage you to take this path. Further, we also 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 information on fees that is needed to make informed decisions.

ASPPA and CIKR share your concern about making sure 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 craft legislation that will accomplish this goal, 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 both H.R. 3765 and H.R. 3185. Specifically, the bills require the disclosure to plan fiduciaries 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 like 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, that would be in the form of the "expense ratio" assessed against the particular investment options chosen by participants, reducing their rate of return for the year.[1] 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—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.[2] 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 to compensate them for performing such services. This is commonly known in the industry as 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.

---

[1] 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).
[2] As discussed earlier, this will be explained in more detail in the investment prospectus.

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.[3]

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 need yet – 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.

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 grow 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.

[3] The DOL will also soon propose regulations under ERISA §408(b)(2) to resume the requirement of 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.

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.

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.[4] 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 can be reasonably accomplished.[5] 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.

---

[4] *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).

[5] An allocation on the basis of the value of plan assets is one possible allocation method.

Disclosure requirements should apply uniformly to all service providers. Both H.R. 3765 and H.R. 3185 do this, and ASPPA and CIKR strongly encourage the Ways & Means Committee to craft and approve legislation that also applies disclosure requirements uniformly. The Ways & Means bill should 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 that they may not need to pay for. 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.

To accomplish this in a reasonable manner, we recommend that the disclosure requirements provide a more simplified service provider fee disclosure that will break down the fees for all services under the following components:

(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 would 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 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.[6] 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 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

[6] 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.

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 occur 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" that 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, to make a truly informed decision as to 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 Ways & Means Committee 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. 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. 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)

ABC Company 401(k) Plan

XYZ Service Provider Disclosure -- Expected Plan Expenses
For Plan Year Beginning January 1, 2008

The following expenses may be charged to to the plan. Some of these expenses may reduce the value of participant accounts. Some plan expenses may be paid by the plan sponsor.

I. Investment Expenses - The investments offered by the plan have related expenses. The amounts listed below are the annual percentage that will be charged based on the amount the participant placed in the particular investment.

EXAMPLE: If the fee is 0.50% and a participant placed $1,000 in that investment for one year, the participant's account would pay $5 for that type of expenses for that investment.

Investment Option	Investment Management Fees[1]	Administrative & Recordkeeping Fees[2]	Selling Costs & Advisory Fees[3]	Total
AAA Investment	0.50%	0.20%	0.25%	0.95%
BBB Investment	0.42%	0.20%	0.25%	0.87%
CCC Investment	0.20%	0.20%	0.25%	0.65%
DDD Investment	0.60%	0.20%	0.25%	1.05%
EEE Investment	0.35%	0.20%	0.25%	0.80%

II. Other Asset Based Fees - These fees are assessed on the total assets in the plan and are not investment specific.

Type of Fee	Investment Management Fees	Administrative & Recordkeeping Fees	Selling Costs & Advisory Fees	Total
Plan Level Fee		0.20%		0.20%
Investment Advisory Fees			0.40%	0.40%
- Plan Expense Reimbursement		-0.20%	-0.25%	-0.45%
Net Fees on Total Plan Assets		**0.00%**	**0.15%**	**0.15%**

III Fees Paid Directly by Plan Sponsor - These fees are paid by the plan sponsor and are not paid out of plan assets.

Type of Fee	Investment Management Fees	Administrative & Recordkeeping Fees	Selling Costs & Advisory Fees	Total
Plan Sponsor Paid Fees		$1,000		$1,000

IV. Total Fees - These are the total fees based on estimated assets of $1 million and 20 participants. The fees assessed on investments are based on the allocation of investments by the 20 participants in the plan as of 90 days prior to the date of this notice. These amounts do not include transactional expenses (see below).

Type of Fee	Investment Management Fees	Administrative & Recordkeeping Fees	Selling Costs & Advisory Fees	Total
Total Expenses on Investments	$4,140	$2,000	$2,500	$8,640
Total Asset Based Fees			$1,500	$1,500
Total Fees Paid by Plan Sponsor		$1,000		$1,000
Total	**$4,140**	**$3,000**	**$4,000**	**$11,140**

V. Transactional Expenses - These fees are only charged when participants request the services described below.

Service	Fee
Brokerage Account	$60 per year
Participant Loan Origination Fee	$50 per loan
Distribution	$35 per distribution (including rollovers)

VI. Conflict Statement

All of the investments are provided by unaffiliated parties. XYZ Service Provider receives revenue sharing from all investments for recordkeeping and administrative services, and for advisory services, which is used to offset fees otherwise charged for such services as disclosed in Section II. above.

[1] Investment management fees are the portion of the expense ratio allocated to investment management expenses.
[2] Administrative and recordkeeping is the portion of the expense ratio attributable to administration and recordkeeping plus any additional administrative and recordkeeping charges attached to the investments.
[3] These include 12b-1 fees and other related selling costs and advisory fees attached to the investments.

ABC Company 401(k) Plan

Direct Participant Expenses

As of January 1, 2007

The following estimated expenses may be charged to your account, depending on the investments you select, the types of services received by the plan and the types of transactions you request. Fees are just one issue to consider when selecting an investment option, and you should consult other information provided by the plan sponsor regarding plan investment options before making a decision.

I. Investment Expenses - The investments offered by the plan have related expenses. The amounts listed below are the annual percentage that will be charged based on the amount you placed in the particular investment. A portion of the fee will be charged if you change your investments during the year. The expense ratio reflects the percentage of fund assets that are used for administrative, management, advertising and promotion (12b-1 fees), and all other expenses and directly affect the returns of your investment options. It does not include sales loads or brokerage commissions.

EXAMPLE: If the Expense Ratio is 0.5% and you placed $1,000 in that investment for one year, you would pay $5 for these types of expenses for that investment. Additional expenses, such as a wrap fee, redemption fee and/or surrender charge may also apply.

Investment Option	Expense Ratio (as a percentage)	Investment-Specific Wrap Fee	Redemption Fee[1]	Surrender Charge[2]
AAA Investment	0.30%	0.00%	0.00%	0.00%
BBB Investment	0.50%	0.10%	0.00%	6.00%
CCC Investment	0.40%	0.20%	2.00%	0.00%
DDD Investment	0.25%	0.00%	1.50%	0.00%
EEE Investment	0.35%	0.00%	0.00%	3.00%
FFF Investment	0.40%	0.10%	0.00%	4.00%
GGG Investment	0.50%	0.00%	1.00%	0.00%
HHH Investment	0.55%	0.25%	1.25%	0.00%

II. Fees on Total Plan Assets[3] - These fees are assessed on the total assets in your account and are not investment specific. Wrap fees are for various expenses, such as sales commissions, administrative expenses, and/or recordkeeping fees.

Type of Fee	Amount of Fee
Wrap Fee	0.35%
Registered Investment Advisory Fees	0.50%
- Estimated Plan Expense Reimbursement Offset	-0.30%
Net Fees on Plan Assets	0.55%

III. Administrative and Transactional Expenses - The Annual Administration and Recordkeeping Charge is paid by all participants. However, the remaining fees (i.e., transactional expenses) are only charged when you request the service.

Service	Amount of Fee
Annual Administrative and Recordkeeping Charge	$50 per year
Brokerage Account	$60 per year
Participant Loan Origination Fee	$50 per loan
Annual Loan Charge	$25 per year
Distribution	$35 per distribution (including rollovers)
Domestic Relations Orders	$100 per order

1 May be imposed by provider as a result of changing your investments multiple times in a given period. See the investment provider's redemption fee policy for additional information.

2 May be imposed if you sell or withdraw money from the investment within a given number of years after you invest. This fee may be reduced based on the length of time your money has been invested. You should consult your plan sponsor for more information before engaging in any transactions with respect to this investment.

3 Wrap fees and investment advisory fees are charged at the plan level. Some plans use expense reimbursements, such as revenue sharing, to offset these costs.

Mr. MCDERMOTT. Thank you for your testimony.
Mr. Jackson.

STATEMENT OF HAROLD L. JACKSON, PRESIDENT AND CEO, BUFFALO SUPPLY, INC., LAFAYETTE, COLORADO, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE

Mr. JACKSON. Thank you, Mr. Chairman, Ranking Member, and Members of the Committee for this opportunity to appear before you today to discuss the appropriateness of retirement plan fees. My name is Harold Jackson. I am President and CEO of Buffalo Supply, a 25 employee, woman-owned small business, specializing in the sale and distribution of medical equipment. We are located in Lafayette, Colorado.

I am pleased to testify today on behalf of the United States Chamber of Commerce where I am a member of the Small Business Council. I am here to bring a small business perspective to the issues. Buffalo Supply has been in the medical equipment and supply business since 1983. We implemented our 401(k) in 2005. The plan we have in place has a 1 year waiting period and covers full-time employees. The company puts in 3 percent of salary, whether or not the employee contributes, and for the past two years, we have included an additional 2 percent profit sharing contribution. Currently, 17 employees are enrolled in our plan and 15 of those make personal contributions. The company pays the administration fees for the plan and the participant pays the quarterly investment fees.

Prior to the 401(k) plan, the company sponsored a simple IRA. Before upgrading to the 401(k), we spent a lot of time debating internally the additional administrative burdens. Basically, we asked ourselves whether, it was worth the benefit to the employees that would be offset hassle. Fortunately, our majority owner has a Ph.D. in taxation and chair of the School of Business at the University of Colorado and had a lot of input on this subject. We determined that even though the administration would be a significant burden, it would be worth the benefit for the employees to be able to put additional savings away in a 401(k).

Upon deciding to implement the 401(k), we did extensive research on our options with respect to service providers. We looked at different providers, researched various arrangements, including both bundled and unbundled packages. We concluded that separate pricing worked better for us because of the relatively small asset base in our plan. Once the assets in the plan grow, however, the bundling option becomes more attractive because of the pricing changes to accommodate the greater asset value. From my perspective, this is much like me giving a large customer a better deal because he is a large customer.

Given our experience, I want to particularly stress the importance of Congress not mandating one type of service arrangement over another. Although we currently use unbundled services, we anticipate growth in our company and growth in our plan and can envision a time when bundled services would be a better option for us. As we have made our decisions, we have been doing so looking at both bundled and unbundled arrangements. Our decision was based on the needs of our company at that point in time, and those needs change. I would like for our company to be able to have as many choices as possible in order to find an arrangement that is a best fit. That will not happen if Congress mandates the choice for us.

Finally, I would ask that Congress proceed cautiously in its decision to implement additional notice requirements. We, of course, want our plan participants to have information that is helpful in making their investment decisions. However, notices that include unnecessary information and are overly burdensome in volume will only increase administrative burden and cost. Although the administration of the notices would be handled by our service provider, we have been told that if Congress implements additional notice requirements, the cost of administering the plan will increase. An increase in cost that does not help participant investment seems contrary to the goal of plan fee disclosure.

As a participant of a small business plan, I appreciate the concerns and issues being addressed here today, and I hope you find my comments useful. I look forward to answering any questions.

[The prepared statement of Mr. Jackson follows:]

Statement of the U.S. Chamber of Commerce

ON:	**TESTIMONY ON THE APPROPRIATENESS OF RETIREMENT PLAN FEES**
TO:	**COMMITTEE ON WAYS & MEANS**
BY:	**HAROLD L. JACKSON**
DATE:	**October 30, 2007**

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

TESTIMONY BEFORE

THE COMMITTEE ON WAYS AND MEANS

OF THE UNITED STATES HOUSE OF REPRESENTATIVES,

ON BEHALF OF THE U.S. CHAMBER OF COMMERCE

ON

THE APPROPRIATENESS OF RETIREMENT PLAN FEES

BY

HAROLD L. JACKSON

TUESDAY, OCTOBER 30, 2007

Thank you, Chairman Rangel, Ranking Member McCrery, and members of the Committee for the opportunity to appear before you today to discuss the appropriateness of retirement plan fees. My name is Harold Jackson, President and CEO of Buffalo Supply, Inc., a 25-employee, woman-owned small business located in Lafayette, Colorado specializing in the sale and distribution of medical equipment and supplies. I am pleased to be able to testify today on behalf of the U.S. Chamber of Commerce where I am a member of its Small Business Council. The Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size, sector and region. Over ninety-six percent of the Chamber members are small businesses with fewer than 100 employees.

Buffalo Supply, Inc. has been in the medical equipment and supply business since 1983, and we are currently the exclusive source for Stryker, Gaymar Industries and Baxa Corporation products. I joined the company in 1990 at which time company revenues were at $1.2 million. By building a strong reputation for service with my customers, I have been able to grow our revenues to the current level of $62 million in 2006.

As President and CEO of Buffalo Supply, Inc., one of my most important duties is to attract and keep highly-qualified employees. It is the employees of Buffalo Supply that carry the banner of our company and maintain the level of customer service that allows us to effectively compete in the marketplace. Therefore, my company offers benefits, including retirement benefits, to attract and retain the best employees. As the operator of a small business, I believe that it is critically important to consider the impact of any potential legislation on the small business plan sponsor. For that reason, I appreciate the opportunity to discuss the issue of plan fee disclosure from the perspective of a small business plan sponsor.

INTRODUCTION

According to the U.S. Small Business Administration, small businesses (less than 500 employees) represent 99.9% of the total firms and over half of the workforce in the United States.[1] Clearly, ensuring adequate retirement security for all Americans means encouraging small businesses to participate in the private retirement system. Small businesses, in general, face significant hurdles and may view retirement plans as yet another potential obstacle and therefore, choose not to establish them. Thus, there have been tremendous efforts to provide incentives and encourage small business owners to establish and maintain retirement plans.[2] Consequently, we are concerned that fee disclosure requirements could possibly undo all of the positive steps that have been made to encourage small business plan sponsors.

Despite the obstacles, and due to certain incentives, small businesses are having success in the retirement plan arena. Small businesses with less than 100 employees cover more than 19 million American workers.[3] Most of these small business employees enjoy generous annual retirement plan contributions from their employers, often in the range of 3 to 10 percent of compensation. Thus, the small business qualified retirement plan system is successful in delivering meaningful retirement benefits for its employees and all efforts should be made to encourage its continued success.

My comments today focus on the concerns of small business plan sponsors as they relate to additional fee disclosure requirements. We urge Congress to proceed cautiously and give significant consideration to the concerns of small businesses. Creating untenable burdens on small businesses plan sponsors could negatively impact the retirement security of millions of workers.

SMALL BUSINESS PLAN CONCERNS

Administrative Burdens Will Negatively Impact Small Business Plan Sponsorship. Small business owners are very sensitive to administrative and costs increases. Due to their size and resources, small business owners often feel these burdens sooner and more deeply than their larger counterparts. Small business owners generally have fewer resources and, therefore, have greater concerns about taking on additional administrative responsibilities. Unlike a large company that may have a dedicated human

---

[1] U.S. Small Business Administration Office of Advocacy estimates based on data from the U.S. Dept. of Commerce, Bureau of the Census, and U.S. Dept. of Labor, Employment and Training Administration.
[2] Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") that was made permanent by the Pension Protection Act of 2006 ("PPA") small businesses may claim a tax credit for establishing a retirement plan equal to 50% of qualifying costs up to $500 per year for the first three years. In addition, the PPA instituted a number of additional positive reforms including the creation of the Roth 401(k), simplification of a number of complex administrative requirements, and the creation of the DB(k) for small businesses.
[3] Patrick J. Purcell, Congressional Research Service (CRS) Report for Congress, Social Security Individual Accounts and Employer-Sponsored Pensions, February 3, 2005, Table 2. Employee Characteristics by Employer Retirement Plan Sponsorship, 2003 at CRS-5.

resources or benefits professional or even an entire department—this function in a small business may be one of several other duties of an employee or, more likely, the owner. Therefore, small business owners will be less likely to establish a retirement plan, if there are going to be significant administrative burdens that they do not have the resources to cover.

Costs Considerations are Important to Small Business Plan Sponsors. Of course, small business owners—like all business owners—are concerned about costs. The costs of maintaining a retirement plan may be a greater consideration for a small business owner, because once a small business decides to establish a retirement plan it is often subject to higher administrative fees than larger companies. A report by the Small Business Administration found that the administrative costs for large companies (over 500 employees) averaged $30 to $50 per participant while the administrative costs for mid-size companies (500 to 199 employees) were slightly higher at $50 to $60 per participant. For the smallest companies, however, (200 and fewer employees), the average administrative costs jumped to over $400 per participant.[4] One reason for the higher cost is that there is a minimum administrative cost to establishing and maintaining a retirement plan and small companies have fewer employees to spread the costs over--the costs per participant can become significantly higher.[5] Therefore, it is critical to keep this distinction in mind when discussing the appropriateness of plan fees.

Moreover, small business plan sponsors have a personal stake in the cost and operation of the plan since they are also generally plan participants. At the start, small business owners typically solicit multiple bids for the contract and ask the potential service providers questions about the plan before signing up for services. Once the plan is established, the small business owner, who is generally also a plan participant, has a vested interest in keeping fees down for both the plan and the participants.

Bundled Service Arrangements are Advantageous to some Small Businesses. For both administrative and costs concerns, there are employers that may prefer to use bundled services for their retirement plans. In terms of administration, it is one-stop shopping. Rather than dealing with several different service providers, the plan sponsor can deal with only one or two; thereby, maximizing the allocation of his or her resources by minimizing administration responsibilities. Furthermore, the pricing of bundled services may be more attractive to some plan sponsors. Again, for a small business plan sponsor who is trying to maximize resources this is an important consideration. Congress should consider the need to increase plan sponsorship in the small business market if it considers any changes to bundled fee arrangements.

Moreover, as an entrepreneur and member of the Chamber, I believe that services and products should be determined by the market and not by Congress. There is a need and support for both bundled and unbundled services. The choice of which service model to use should be made by the consumer—in this case the plan sponsor—based on its

[4] JOEL POPKIN AND COMPANY, SMALL BUSINESS ADMINISTRATION, OFFICE OF ADVOCACY, COST OF EMPLOYEE BENEFITS IN SMALL AND LARGE BUSINESSES 38 (2005).
[5] *Id.*

needs and resources. We sincerely urge Congress not to mandate one type of service arrangement over another.

Bundled Service Arrangements are Consistent with Fiduciary Obligations. The fiduciary of the trust (normally 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.[6] In other words, the fiduciary has a duty under Employee Retirement Income Security Act to ensure that any expenses of operating the plan, to the extent they are paid with plan assets, are reasonable. We do not believe that bundled services in any way impede the plan sponsor's ability to carry out its fiduciary duties. On the contrary, as long as the plan sponsor receives information that includes all of the services provided and the total costs, he or she should be able to compare this to information from other bundled providers as well as unbundled providers and determine whether the fees, taken in totality, are reasonable for the services being provided. As long as the plan sponsor is fully informed of the services being provided, it can compare and evaluate whether the overall fees are reasonable without having to analyze fees on an itemized basis.

Anticipated Liabilities May Drive Small Business Owners Away from Plan Sponsorship. Finally, we should not underestimate the small business owner's concern over additional liabilities (even if they are only perceived). Over the past year, plan fees have been the subject of congressional hearings, lawsuits, and newspaper articles. While this publicity has highlighted the importance of plan fees, it has also created a negative impression of plan fees and plan sponsors. Thus, even though there have not been any findings of abuse, there is a heightened scrutiny of plan fees.[7] A small business owner who does not have the resources to hire an outside analyst may become wary of offering an individual account plan at all. In addition, some small business owners may have a difficult time obtaining fee information from their service providers in a format that they can easily digest and provide for their participants. The ERISA Advisory Council warned that "a balance must be struck between what can reasonably be expected of small plan sponsors and the potential capabilities of larger plan sponsors."[8] For example, statements that imply that there is an "average" amount for plan fees can be misleading to participants in small business plans for the reasons mentioned above and lead to additional liability for the plan sponsors. Therefore, it is critical to proceed cautiously

---

[6] ERISA section 404(a)(1).

[7] Despite the negative publicity, there has not yet been any proof that participants are paying excessive fees. In 1997, the Department of Labor had 50 401(k) plans analyzed by a fee expert to determine if they were reasonable. The expert found that although the fees were high, they were not unreasonable. (UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, PRIVATE PENSIONS: *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees* 22 (2007)) Recently, the first court to look at the issue of plan fees determined that the plaintiffs did not have a claim and dismissed the case. (Hecker v. Deere & Co., No. 06-C-719-S (W.D. Wis. June 21, 2007)) Consequently, it is important to approach potential reforms as improvements to a system that is working and not as rules needed to fix a broken system.

[8] ADVISORY COUNCIL ON EMPLOYEE WELFARE AND PENSION BENEFIT PLANS, ERISA ADVISORY COUNCIL, REPORT OF THE WORKING GROUP ON FEE AND RELATED DISCLOSURES TO PARTICIPANTS 5 (2004).

and thoroughly consider all implications associated with any future changes or requirements.

GENERAL PRINCIPLES ON PLAN FEE DISCLOSURE

For this hearing, we were asked to specifically highlight the concerns of small business plan sponsors. Of course, the issue of plan fee disclosure concerns Chamber members of all sizes; therefore, it is important to share the Chamber's general principles on plan fee disclosure. On July 24, 2007, the Chamber submitted a letter to the Employee Benefits Security Administration (EBSA) in response to the request for information on fee and expense disclosures to participants in individual account plans. The Chamber's comments reflected not only concerns about new rules on plan fee disclosures, but also formed the principles with which the Chamber views any forthcoming reforms to plan fee disclosures. These principles are outlined below.

The Importance of Plan Fees Should be Considered in the Appropriate Context. Over the past year, plan fees have received a lot of publicity. While highlighting the importance of fees in the investment context, this publicity has also possibly had the negative effect of implying that plan fees are the only factor to consider when making investment decisions. This could be detrimental to both participants and plan sponsors.

Participants making investment decisions should not rely solely on the fees associated with the investment option. While the fees are an important part of the consideration, there are several other factors that may be considered, such as historical performance and investment risk. In its testimony before Congress, the Government Accounting Office (GAO) also recognized the importance of a variety of factors when making investment decisions, even noting that "[h]igher fees can also arise if an investment option has additional features."[8]

Similarly, plan sponsors may begin to feel that they need to choose the least expensive investment option in order to avoid litigation claims. However, the lowest fees are not a guarantee of the best performance. Moreover, plan sponsors may desire services or features that are not included in the lowest fees. Therefore, it is necessary for plan sponsors to also consider expenses in the greater context of investment performance and features.

Fee Disclosures to Participants Should be Useful and Easy to Understand. As you are aware, plan participants already receive many notices from the plan. While some participants may read and digest these notices, most participants bypass the information without receiving any benefit from it. For this reason, we believe that fee information provided to participants should be stated as clearly as possible. In addition,

[8] UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, PRIVATE PENSIONS: *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees* 19 (2006).

the Chamber recommends that this information be combined with other notices already required to be sent to the participant.

The Chamber also suggests that information on fees should be limited to the amounts that are paid by the participant. There is general agreement that analyzing plan fees between providers, plans, and participants is complicated. Each individual plan sponsor determines how much of the fees they will pay and how much participants will pay. As mentioned above, plan sponsors consider a number of factors in addition to expenses when choosing a service provider. If the plan sponsor chooses to pay those additional costs and it does not impact the participants' accounts, then this information is not relevant to the participants and may create unnecessary confusion.

Disclosure Requirements Should Not be Unduly Burdensome. Plan sponsors are subject to numerous statutory and regulatory requirements and must constantly balance costs against the benefits of maintaining the retirement plan. Consequently, it is important to minimize the burdens on plan sponsors. In its 2004 report, the ERISA Advisory Council noted this concern:

> The working group wants to avoid a rule that is so burdensome that it discourages the adoption and maintenance of defined contribution plans. Section 401(k) plans in particular have become popular and convenient investment vehicles for the US workforce. Disclosure rules should not be so onerous that they impede this popular and useful savings vehicle.[10]

The Chamber very much agrees with this statement and urges this to be kept in mind as the process moves forward.

The Chamber does not have a specific proposal for the disclosure format, but has several general recommendations. We recommend that disclosure information be as efficient in length as possible to keep participants from being overwhelmed with information. If possible, we also recommend that fee information be included as part of other notice requirements to minimize the amount of notices that are being created and sent. For example, including fee information with the participant benefit statement or the summary annual report should be considered. Finally, we recommend that plan sponsors be given flexibility in the method of distribution of the notice (electronic, paper, intranet, etc.) and in design of the notice. Because plans and investment options vary significantly, it could be a tremendous burden on some plan sponsors to have to comply with rigid criteria.

Small Business Plan Sponsors May Require Additional Consideration. For all of the reasons mentioned above, we believe that it is critical to consider the additional burdens and obstacles that may be placed on small business plan sponsors when considering possible legislation.

---

[10] ADVISORY COUNCIL ON EMPLOYEE WELFARE AND PENSION BENEFIT PLANS, ERISA ADVISORY COUNCIL, REPORT OF THE WORKING GROUP ON FEE AND RELATED DISCLOSURES TO PARTICIPANTS 5 (2004).

Guidance on Plan Fee Disclosure is Best Provided by the Department of Labor. In its report, the GAO recommended a number of amendments to the Employee Retirement Income Security Act.[11] However, the Chamber believes that guidance is best provided through the Department of Labor (DOL) and Employee Benefits Security Administration (EBSA). Changes to statutes require a significant amount of time to research and change. Regulatory guidance, however, is easier to adjust while still providing a critical opportunity for comment and discussion. As we have seen, changes in the financial industry are constantly occurring. In order to ensure that plan fee disclosures remain useful, we recommend that the DOL and EBSA provide this guidance so that necessary changes to disclosures can be made in a relevant and timely manner.

CONCLUSION

As more workers become dependent on individual account plans for retirement, it becomes increasingly important to provide participants with information that will allow them to make well-informed decisions. Given the complicated nature of plan fees, it is not a simple task to discern which information and what format will prove most meaningful to participants—rather, it will take input and dialogue from many different parties and experts.

In particular, the concerns of small business plan sponsors need additional consideration. Unreasonable administrative requirements, additional liabilities, and potential costs increases will drive small businesses away from the private retirement system. At a time when small business retirement plans are beginning to experience success, we should encourage these efforts by creating requirements that fully consider the concerns and possible consequences to small business plan sponsors. We appreciate the opportunity to express our concerns and look forward to future conversations with you and other interested parties.

[11] UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, PRIVATE PENSIONS: *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees* 4 (2006).

Mr. MCDERMOTT. Thank you for your testimony.
Ms. KLAUSNER.

STATEMENT OF ALLISON R. KLAUSNER, ASSISTANT GENERAL COUNSEL, BENEFITS, HONEYWELL INTERNATIONAL, INC., MORRISTOWN, NEW JERSEY, ON BEHALF OF THE AMERICAN BENEFITS COUNCIL

Ms. KLAUSNER. Thank you. Good afternoon, Chairman and Members of the Committee. My name is Allison Klausner, and I am Assistant General Counsel of Benefits in the New Jersey office of Honeywell International, Inc. We are a member of the American Benefits Council, on whose behalf I am testing today.

I appreciate the opportunity to present testimony with respect to 401(k) plan fees. Like you, Honeywell and the Council want a voluntary, employer-based 401(k) system to successfully provide workers with a reasonable opportunity to save for retirement. A successful 401(k) system requires that the cost of operating the system not outweigh the benefits. This in turn requires plan sponsors and service providers and other fiduciaries to engage in meaningful dialog. This will ensure, one, that plan sponsors implement services appropriate to maintain and operate plans; and, two, that the cost of such services is reasonable and appropriate. Finally, this dialog should enable plan sponsors to disclose to participants, appropriate information regarding the key elements of the plan, the services supporting the plan, and the cost of such services.

At Honeywell, we have obtained the fee information from our 401(k) service providers, and we are confident that the process enables us to provide our participants with a plan that successfully supports their retirement savings goals. We do believe, however, that the dialog between plan service providers and plan sponsors generally can be improved.

There are three key points that I would like to note in my remaining time: First, Honeywell, like the other members of the Council, does not support legislative or other mandates that would increase the cost born by participants and would deter employers from offering 401(k) plans. We strongly believe that the fee disclosure to 401(k) participants should supplement and complement financial education regarding the benefits of savings within the parameters of a 401(k) plan. We encourage fee disclosure to be a part of financial education, as that coupling will ensure that plan participants consider fees together with other important investment considerations, such as diversification among asset classes, historical investment performance, and risk and return factors. The fee disclosure should not leave participants to mistakenly believe that choosing the lowest cost investment vehicle will result in the greatest savings.

The information disclosed to participants must not be too complicated, too burdensome or too costly. If the information provided is overly detailed, the information will not be useful. The fee disclosure to participants should be designed to encourage participants to consider fees when making all their 401(k) decisions, including participation, rates of contributions, loans, withdrawals, and investments. The bottom line is that neither Congress nor the Department of Labor should require 401(k) plans to operate in a system that places a disproportionate focus on plan fees.

Second, plan sponsors know their employee population and know what plan designs and features are important to encourage employees to maximize retirement savings within the employer's 401(k) plan. Although plan features may be viewed as unnecessary bells and whistles, the decision to offer a robust 401(k) plan may be what is best for the employer's population. Robust 401(k) plans require services to support them and these services will add to the total fees paid to run the plans. But if the 401(k) plan features are stripped down, employees may not participate at all. Thus, a focus on minimizing fees alone, without consideration of the overall 401(k) plan design, may result in fewer 401(k) plan participants and fewer retirement dollars saved.

Third, plan sponsors, like Honeywell, diligently consider the capabilities and qualities of vendors engaged to support our 401(k) plan. Not all 401(k) service providers could support our 401(k) plan, which has a significant amount of complexity due to Honeywell's high volume of corporate acquisitions, mergers and divestitures. We cannot simply select a recordkeeper strictly on the basis of who bids the lowest fee. We need to engage a recordkeeper who can quickly and correctly implement necessary plan changes due in part to corporate activity. Honeywell must determine which vendors are capable of providing quality support for our 401(k) system and fees are only one component of that determination.

In conclusion, Honeywell and the Council are pleased to support enhanced disclosure of plan fees, but undue focus on fees relative to other factors may simply result in additional cost being born by plan participants and fewer retirement savings in the employer-sponsored voluntary 401(k) system.

I will be pleased to answer any questions that you may have.

[The prepared statement of Ms. Klausner follows:]

AMERICAN BENEFITS COUNCIL

TESTIMONY OF ALLISON R. KLAUSNER

ON BEHALF OF

AMERICAN BENEFITS COUNCIL

BEFORE THE

HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS

FOR THE HEARING

ON THE

APPROPRIATENESS OF RETIREMENT PLAN FEES

TUESDAY, OCTOBER 30, 2007

Introduction.

My name is Allison Klausner and I am the Assistant General Counsel - Benefits for Honeywell International Inc. ("Honeywell"). Thank you very much for the opportunity to testify today on an issue of great interest to Honeywell and to me.

I am here today on behalf of the American Benefits Council (the "Council"). 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. Honeywell serves on the Council's Board of Directors and actively participates both directly and through the Council in public policy discussions regarding benefits issues confronting our country.

The Council very much appreciates the opportunity to present testimony with respect to 401(k) plan fees. We applaud Chairman Rangel and Ranking Member McCrery for their leadership with respect to retirement plan issues and for holding this hearing. We also want to thank Congressman Neal for his bill on plan fee disclosure, which in our view reflects careful consideration of a number of important issues and makes an excellent contribution to the public policy discussion.

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. The goal should be a 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.

The objective of Honeywell and other plan sponsors very simply is to maximize benefits for our employees within the parameters of our 401(k) plan designs as well as the contribution and other limitations established by the Internal Revenue Code. This very simple objective helps us analyze very effectively a whole set of complicated issues. This, of course, includes evaluating whether 401(k) fees charged by service providers are reasonable; determining whether the selection of service providers is appropriate; analyzing whether the relationship between the fees and the service being provided is reasonable, taking into account any revenue sharing received by service providers in conjunction with the specific plan; and evaluating what information will be most useful to plan participants to ensure that they are able to make the best choices amongst those offered by the plan. The flexible framework that ERISA provides for plan sponsors to structure their contractual arrangements is critical in achieving our goal of maximizing benefits for plan participants. It is therefore very important that any enhanced disclosure requirements not interfere with the important aim of 401(k) plans – encouraging adequate savings for retirement.

We Support Enhanced Disclosure And Reporting Requirements.

With respect to 401(k) plan fees, we believe that this Committee would be pleased by what the Council's 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.

In a recent survey done by Hewitt, 77% of employer plan sponsors surveyed were either very or somewhat likely to undertake a review of fund expenses, revenue sharing, and disclosure of plan fees to participants. Like many other plan sponsors, at Honeywell, we have asked and will continue to ask hard questions about plan services, fees charged, and other compensation earned or paid to plan service providers. The information we are getting is giving us the tools we need to confirm that fees charged are appropriate and reasonable or to negotiate effectively for lower fees and excellent services. Likewise, this information is helping us to provide meaningful information to our plan participants.

Honeywell's 401(k) plan is one of the larger 401(k) plans with over 75,000 participants and almost $10 billion in assets. Approximately 90 percent of our active employee population is enrolled in and contributing to the plan. Our plan participants are quite pleased with our 401(k) plan and we are proud of its success. We are proud of the plan design and we are proud of the manner in which we handle our fiduciary duties with regard to the plan – including our duties to ensure that plan fees and expenses directly and indirectly paid to service providers are reasonable and appropriate. Honeywell's plan fiduciaries have implemented processes to ensure that providers' fees and expenses are reasonable and appropriate relative to industry benchmarks and relative to the type, quantity, and quality of services provided. Clearly as a large plan sponsor, my comments are geared somewhat towards that market. However, input to the Council reflects that in the small plan market, heightened awareness of existing fiduciary responsibilities already is helping small employers shop more effectively among service providers.

However, we need to strive to make the fee disclosure system even better. What can we do to accomplish this goal? We need to ensure that all plan fiduciaries and service providers engage in the types of practices I have described. Those practices start with a meaningful dialogue between plan fiduciaries and service providers regarding the direct and indirect fees that service providers receive from the plan or from unrelated third parties. Those practices also include clear, easy-to-understand disclosure to participants.

Department of Labor and Government Accountability Office

With respect to fee disclosure, 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, also as I have discussed. 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 as they are issued, 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. In addition to my testimony on behalf of the American Benefits Council as a witness at the Department of Labor's EBSA Advisory Council last month, the American Benefits Council, together with other trade organizations, has been working in a constructive manner with the Department to help it improve fee disclosure and transparency for years. In 2006, the American Benefits Council, together with a group of trade 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.

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.

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 the available fund choices and select investments designed to help them achieve retirement security. Disclosure to plan fiduciaries equips fiduciaries with the information necessary to negotiate and shop for the services appropriate to support the sponsor's plan design. 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.

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. 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 or increase exposure to liability. 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 recognize that communication with 401(k) plan participants is much broader than fees and that communication is at the core of achieving sufficient levels of participation and adequate levels of savings by participants. Participants need to understand the fees they are paying within the context of the services they are receiving and the overall impact on the investment options available to them. Disclosure of overly detailed or granular information does not help plan participants in these respects. Moreover, participants must recognize that fees are only one factor to consider in choosing an investment fund. Fee disclosure must not be elevated in a manner that discourages plan participants from considering potential or expected investment returns, personal investment horizon, risk tolerance, and other factors when making investment fund decisions, as well as decisions regarding participation in, contributions to, and distributions from the plan.

Honeywell believes strongly that any requirement regarding fee disclosure must be carefully crafted so that participants are not inadvertently led to think that selecting an investment option with the lowest fee is always the right choice. As we know, an investment option with low fees may generate higher or lower net investment returns relative to an investment choice with higher fees. Overly detailed or granular disclosure requirements may actually result in even higher fees for plan participants or more limited choices. In addition, excessive detail can serve to obscure key points. In contrast to the simple and clear disclosure which is appropriate for plan participants, plan fiduciaries need more detailed information to fulfill their fiduciary duties and 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. 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 funds may logically have higher than average expenses, but it is the net performance of the investment 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 choices, 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 and different plans need different services. Accordingly, the 401(k) plan market has attracted a variety 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 has enabled plans to avoid paying for services that are unnecessary for their plan designs or otherwise not wanted or used, and increases the options available to plan sponsors seeking to find providers and services that meet the unique needs of their plans and their participants.

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. Other employers design their plans to avoid certain expenses, such as discrimination testing. 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?

Marketplace competition among investment options and service providers is intense, which exerts downward pressure on fee levels. In fact, often plan investment fees are much lower than the fees charged outside the context of 401(k) 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.

It is critical to note that, since fund performance is often determined after expenses are netted out, investment expenses are reviewed in the context of reviewing the performance of investment funds. Plans fiduciaries routinely review fund performance. At Honeywell, plan fiduciaries meet often to discuss and review fund performance and others who have been appointed to monitor the fund performance constantly engage in such activity. And the process employed by Honeywell's 401(k) plan fiduciaries is similar to those of many 401(k) plan fiduciaries. According to a 2006 survey by the Profit Sharing/401k Council of America, 62% of plans review plan investments at least quarterly and substantially all plans conduct such a review at least annually.

With respect to other plan fees, due to the intense competition among service providers, plan fiduciaries are able to successfully shop for and/or negotiate fees which are reasonable to support the sponsor's plan design and the needs of the plan's participants.

Additional Principles With Respect To Plan Fee Issues.

There has been a vigorous and informative public policy discussion during the current year 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. Consider, for example, the difficulty of calculating fees which are based on a percentage of assets or are based on the number of participants. As participants move in and out of investment funds on a daily basis throughout the 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 the number of participants as well as 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 recordkeeping or other 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 choices 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.

Of course, even in the absence of a specific disclosure requirement, a plan fiduciary in a particular situation may ask for information about the allocation of revenues within an affiliated group. ERISA provides the current plan marketplace with all the tools necessary for fiduciaries and service providers to engage in a dialogue about any service-related issue. Accordingly, we are not suggesting that the fiduciary may not ask such questions; we are only suggesting that a rigid rule that requires such disclosures would be extremely costly and would produce a great deal of unhelpful information.

- **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 fiduciary 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.

Mr. MCDERMOTT. Thank you, Ms. Klausner.
Mr. MINSKY.

STATEMENT OF LEW I. MINSKY, SENIOR ATTORNEY, FLORIDA POWER & LIGHT COMPANY, JUNO BEACH, FLORIDA, ON BEHALF OF THE ERISA INDUSTRY COMMITTEE

Mr. MINSKY. Thank you for the opportunity to discuss this complex and important topic that directly affects the retirement security of millions of Americans who participate in defined contribution retirement plans. Let me begin by making three key points: First, major employers urge Congress to defer legislative action until after the DOL completes its current fee disclosure projects and the results of these efforts can be evaluated.

Second, major employers support efficient and effective fee disclosure and take their responsibilities for ensuring the reasonableness of plan fees very seriously. Our efforts have resulted in widespread access to the financial markets at fees typically lower than otherwise available.

Third, major employers are concerned that missteps on fee disclosure could inadvertently damage the defined contribution system and threaten the retirement security of millions of American workers. We strongly urge Congress to defer legislative action until after the DOL completes its regulatory projects, which are already well underway. Adding new legislative requirements at this point would likely result in the substantial delay before enhanced disclosures become available to plan sponsors and participants.

We believe that the flexibility inherent in the regulatory process makes it a more appropriate avenue for adopting new disclosure requirements. Adding rigid fee disclosure requirements to ERISA would inhibit the ability of plan sponsors and service providers to work together and create new investment options and administrative solutions that ultimately improve retirement security. That said, we want to be clear that we strongly support effective and efficient fee disclosure. ERIC, PSCA, the Chamber, NAM, and eight other organizations worked together to develop a comprehensive set of principles that should be embodied in any new fee disclosure requirements. We urge that any new legislation be measured against these basic principles, which are contained in our written testimony.

The cost of any disclosure requirements must be justified by their benefits. The disclosure requirements currently being proposed would dramatically increase the administrative cost plan participants pay while overwhelming them with information that is of little practical value to them.

With all of the current discussion surrounding the need for new disclosure requirements, it is important to remember that employers and plan fiduciaries are already playing an important role in controlling fees paid by 401(k) plan participants. The existing structure of ERISA requires that plan fiduciaries ensure that plan fees are reasonable. Major employers take this responsibility very seriously. We believe that a new set of rigid rules that govern the fiduciary process will ultimately lead to less appropriate decisions being made. In meeting their duty to ensure that fees are reasonable, plan fiduciaries take into account the unique needs of the participants in their plan. In considering the range of services and fees that make sense for their plan participants, prudent fiduciaries may come to different conclusions about what plan investments, services and service providers are appropriate. For example, employers with a more financially sophisticated workforce may choose a largely self-directed program, while employers with employees more apt to leave their investments unattended may select a program which focuses more on life cycle funds and managed accounts. The cost of these programs will vary significantly, but as long as the fees paid are reasonable for the services provided, plan sponsors should have the flexibility to create 401(k) plans that work for their workforces.

We are extremely concerned about the misuse of fee disclosure requirements as the basis for litigation fishing expeditions. To date, more than a dozen lawsuits have been filed against employers with vague claims of fiduciary breaches related to plan fee disclosure. These often groundless allegations do great damage to the 401(k) system by diverting funds from employer contributions to increased legal and administrative expenses.

In conclusion, we strongly believe that the regulatory process is the appropriate place to address 401(k) fee disclosure. We encourage the Committee to allow DOL to continue its work, evaluate the results and determine if new legislation is needed. It would be a tragic irony if legislation intended to improve the ability of plan participants to make good investment decisions ultimately leads to higher costs and lower participation in the retirement system.

Thank you for the opportunity to testify on this important topic. I look forward to your questions.

[The prepared statement of Mr. Minsky follows:]

TESTIMONY OF
LEW MINSKY

ON BEHALF OF

THE ERISA INDUSTRY COMMITTEE
PROFIT SHARING/401K COUNCIL OF AMERICA
NATIONAL ASSOCIATION OF MANUFACTURERS
AND
U.S. CHAMBER OF COMMERCE

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

IN THE HEARING ON
THE APPROPRIATENESS OF RETIREMENT PLAN FEES

TUESDAY, OCTOBER 30, 2007

Chairman Rangel, Ranking Member McCrery, and Members of the Committee, thank you for the opportunity to submit the views of The ERISA Industry Committee (ERIC), the Profit Sharing/401k Council of America (PSCA), the National Association of Manufacturers (NAM), and the U.S. Chamber of Commerce (the Chamber) on the issue of 401(k) plan fee disclosure.

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 manor.

Established in 1947, 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.

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 Chamber 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.

ERIC, PSCA, NAM, and the Chamber appreciate and commend the Committee on its recognition of the importance of fee disclosure. This is a complex and important topic that affects the millions of Americans who participate in 401(k) and other defined contribution retirement plans. Let me begin, by making three key points:

1. Major employers strongly urge the Congress to defer legislative action until after the Department of Labor completes its current fee disclosure projects and the results of those efforts can be evaluated.

2. Major employers support efficient and effective fee disclosure and take their responsibilities for ensuring the reasonableness of plan fees seriously. Our efforts

have resulted in widespread access to the financial markets at fees typically lower than otherwise available.

3. Major employers are concerned that missteps on fee disclosure could inadvertently damage the defined contribution retirement system and threaten the retirement security of millions of workers.

Reform is Underway

It is important that the Committee is fully aware that a regulatory process for fee disclosure is under way, initial regulations are expected within the next few weeks and legislation is neither necessary nor would it be helpful to resolve the issues affecting disclosure to employers and to plan participants. The Department of Labor (DOL) has already begun work on a series of comprehensive regulations to govern 401(k) plan fee disclosure. ERIC, PSCA, and other stakeholders, including those representing plan participants, have been actively engaged in this process and continue to work closely with the DOL to ensure that any new disclosure requirements strike an appropriate balance between the often-competing goals of efficiency and effectiveness.

The DOL has indicated that it will soon release the final modifications to the Form 5500 and accompanying Schedule C, on which sponsors report fees paid to plan service providers. The new form will increase the number of service providers included and create new requirements to report service provider revenue sharing arrangements.

In the next few months, DOL is expected to issue a proposed regulation under ERISA Section 408(b)(2). This section requires that plans pay no more than reasonable compensation to plan service providers. The proposal is expected to ensure that plan fiduciaries have access to the information about all forms and sources of compensation that service providers receive. Both sponsors and providers will be subject to new 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 final DOL fee initiative is expected to provide extensive new guidance on what and how plan sponsors should disclose information to plan participants. To that end, the DOL issued a request for information (RFI) in April 2007 requesting comment from all stakeholders on the current state of fee disclosure, existing disclosure requirements and practices, and possible new disclosure rules. In response to the RFI, nearly 100 organizations and individuals representing a wide cross section of all concerned submitted detailed comments to DOL. The Department has stated that it will propose in early 2008 new participant disclosure rules governing all participant-directed individual accounts.

We strongly urge Congress to defer legislative action until after DOL completes these regulatory projects. DOL's projects are well underway and are the result of substantial input from stakeholders that represent various viewpoints on this important topic. New legislative requirements at this point would likely result in a substantial delay before enhanced disclosure would become available for plan sponsors and participants.

In addition, the flexibility inherent in the regulatory process makes it a more appropriate avenue for adopting new disclosure requirements. Legislation that adds rigid fee disclosure requirements to ERISA would lock in disclosure requirements and inhibit the ability of plan sponsors and service providers alike to create new investment options and administrative techniques that improve retirement security. Moreover, when these barriers arise, removing them may prove problematic, as legislation is often difficult to change for reasons unrelated to the merits of the proposals being considered.

For these reason, We are concerned that adding new statutory fee disclosure requirements would unnecessarily slow the evolution of 401(k) plans, which have enhanced the benefits provided to participants in recent years through new innovations such as target-date and lifecycle funds, and managed accounts. Because the regulatory process is more flexible and regulations can be more easily changed and updated to reflect new investment options, strategies, and products, we believe that a regulatory solution will be far more beneficial to plan participants in the long term.

Major Employers Support Effective and Efficient Fee Disclosure

Employers strongly support effective and efficient fee disclosure. ERIC, PSCA, NAM, the Chamber, and eight other organizations worked together to respond to the DOL's April RFI and put forward a comprehensive set of principles that should be embodied in any new fee disclosure requirements. Those principles include:

- **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 "unbundled" 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 basic principles.

Current Law Places Limits on Plan Fees

With all of the discussion surrounding the need for new disclosure requirements, it is important to remember that employers and plan fiduciaries already play an important role in controlling fees paid by 401(k) plan participants.

The Employee Retirement Income Security Act of 1974 (ERISA) already places requirements on plan administrators and provides significant safeguards for employee assets. ERISA requires that plan assets be held in a trust separate from employer assets. ERISA requires that the trust assets be held for the exclusive purpose of providing benefits to participants and their beneficiaries, and ERISA requires that only reasonable expenses for administering the plan may be paid from plan assets.

Thus, the existing structure of ERISA already places a requirement upon plan fiduciaries to ensure that plan fees are reasonable. Major employers take this responsibility seriously.

We believe that a new set of rigid rules that govern fiduciary process will ultimately lead to less appropriate decisions being made. In meeting their duty to ensure that fees are reasonable, plan fiduciaries take into account the unique needs of the participants in their plan. Thus, prudent fiduciary judgments regarding fees and service providers that are made by plan fiduciaries for one plan may be very different that the decisions that make sense for another plan with participant that have different needs.

Moreover, in considering the range of services and fees that make sense for their plan, prudent fiduciaries may come to different conclusions about the right products and service providers. Employers with more a more financially sophisticated workforce may choose a largely self-directed program with numerous investment options, while employers with employees more apt to leave their investment unattended might select a program that focuses more heavily on life-cycle funds, managed accounts, or other less participant-directed options. The cost of providing these programs might differ significantly, but as long as the fees paid are reasonable for the services provided, plan sponsors should have the flexibility to create 401(k) plans that work for their workforces.

Employers might also use different methods for ensuring that plan fees are reasonable. Different plan sponsors will choose different processes based on the needs of their plans. There are numerous methods that plan sponsors might choose to evaluate the fees paid by their plan. It is important that plan sponsors be allowed to fulfill their fiduciary obligation to ensure plan fees are reasonable in the manner most appropriate for their plan, unencumbered by rigid statutory processes. A non-exhaustive list of potential methods plans might choose include:

- The use of a competitive bidding process such as a formal request for proposal process to compare the fees charged by various service providers at the time they enter into a contract;
- Reevaluating the fees paid by their plan regularly to ensure that the fees paid by there are reasonable in light of changes in their plans characteristics;
- They may also engage in internal reviews or hire benchmarking companies and outside consultants to evaluate the level of fees paid by their plans for services and to ensure that they are objectively reasonable; and
- Large employers may leverage their plan's size and other assets to bargain for lower fees than would otherwise be available.

401(k) Participants Have Benefited from Current Practices

While some have charged plan sponsors with allowing hidden fees to eat into worker's retirements, the reality is that the current system has generally been good for 401(k) participants with regard to fees. Plan participants typically have access to the market at lower costs than retail investors, while participants in major employer plans typically experience the lowest fees.

CEM Benchmarking Inc. studied 88 US defined contribution plans ranging from $4 million to over $10 billion in plan assets with 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. Plans with assets in excess of $10 billion averaged 28 bps while plans between $0.5 billion and $2.0 billion averaged 52 bps.

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 basis points or 0.22 percent.

Potential Missteps Could Harm the 401(k) System

If the Committee chooses to proceed with new fee disclosure legislation, and we urge that you do not at this time, we caution the Committee to ensure that it does not inadvertently harm the participants it aims to protect. We would urge that the Committee consider the principles outlined in our testimony as the basis for any new disclosure requirements. The failure to do so could result in increased fees for plan participants, increased litigation against plan sponsors, and, ultimately, less generous and fewer 401(k) plans for participants.

We are extremely concerned about the misuse of fee disclosure requirements as the basis for litigation fishing expeditions. To date, more than a dozen lawsuits have been filed against employers—many of them against ERIC members—alleging vague claims of fiduciary breach related to plan fee disclosure. Many of these lawsuits were filed by one firm using the same or very similar language demonstrating a lack of any real evidence of wrongdoing. These suits are often "strike-suits" seeking some form of pre-trial financial resolution without regard to the actual presence of wrongdoing.

These often-groundless allegations do great damage to the 401(k) system. Employers who have already been sued are spending hundred of thousands or millions of dollars defending themselves against claims which in many cases have no basis in reality. Employers who have not been sued—worried that they may be next—are engaged in comprehensive and costly reviews of their 401(k) plans that go well beyond the statutory requirements to help protect themselves from suit. Thus, the twin threats of lawsuits and overreaching legislation have become reasons for some employers to reconsider whether they should continue to provide any form of retirement plan. Some of those employers are former sponsors of defined benefit plans who, because of similar reasons, have retreated from the defined benefit universe.

These additional costs have a very real and negative impact on plan participants. Faced with higher legal costs surrounding their plans, large employers may choose to reduce the size of their employer contributions or curtail them altogether. Smaller plans—and even some larger ones—may choose to discontinue their plans rather than face the increased threat of litigation. The fear of litigation may also result in increased disclosure for disclosure's sake that provides participants with little useful information, but greatly increases the administrative costs paid by plan participants.

Similarly, the cost of any new disclosure requirements must be justified by their benefits. Many of the disclosure requirements currently introduced in the House would create a complex and burdensome disclosure regime. Such disclosure would dramatically increase the administrative costs paid by plan participants while overwhelming them with information that is of little practical value as they make the decision to participate in the 401(k) plan and the decision of which investment option to select.

Conclusion

We strongly believe that the regulatory process is the appropriate place to address the concerns that have been raised about 401(k) plan fees and disclosure. We encourage the Committee to allow DOL to continue its work on fee disclosure, evaluate the results, and then determine if new legislation is needed.

We believe that a disclosure regime that provides participants and plan sponsors with the information they need to make their respective decisions about plan fees is achievable. It is critical that such a system not overwhelm participants with voluminous, granular information that does not aid the decision making process.

It would be a tragic irony if an attempt to improve the ability of plan participants to make good investment decisions ultimately led to higher costs and lower participation in the retirement system.

Mr. MCDERMOTT. Thank you very much for your testimony. Mr. Stevens.

STATEMENT OF PAUL SCHOTT STEVENS, PRESIDENT AND CEO, INVESTMENT COMPANY INSTITUTE

Mr. STEVENS. Thank you, Mr. Chairman and Members of the Committee. I am pleased to take part in today's hearing on behalf of the Investment Company Institute (ICI), the national association of U.S. mutual funds. Mutual funds have helped foster the growth of the defined contribution retirement system. They manage more than half of the $4.1 trillion that Americans have invested in 401(k) and other DC plans. For more than two decades, funds have sought to improve the services and investment options available to retirement savers, and ICI has advocated a regulatory framework that best serves America's workers and employers.

Today, I would like to cover three topics: First, I want to emphasize, based on our research and that of others, that the 401(k) system shows every sign of success and it will work even better as automatic enrollment and other recent reforms take hold. Secondly, I will discuss how we need to further improve the 401(k) system by addressing gaps in current disclosure. Finally, I will discuss the servicing of 401(k) plans and urge that Congress resist calls to dictate one business model for 401(k) service providers over another.

With respect to the success of the 401(k), one must bear in mind that this system is only 26 years old. No worker in America has enjoyed a full career with 401(k) plans. But the system does warrant the confidence that American workers and businesses are placing in it.

Our organization is a leading center of research on the 401(k) system. With the Employee Benefit Research Institute, we have developed the Nation's largest database on 401(k) accounts. We have used this database to analyze the savings power of 401(k) plans, how workers use their accounts and how they allocate their investments. We have also used it to project how today's young workers will fare when they retire 25 or 30 years hence. Our projections, based on typical career paths and worker behavior, indicate that participants at all income levels can expect 401(k) savings to replace a substantial portion of their pre-retirement income.

Research indicates that 401(k) plans are working. Can they work even better? Yes. Better disclosure practices would help. It is high time we close gaps in disclosure rules and provide clear information to workers and employers.

Research on investor behavior suggests that workers need a clear, concise summary of five items for each of the investment options available under a 401(k) plan. These items include the investment's objectives, its historical performance, its risks, and information about the investment manager, and fees. Of all the investment options available in 401(k) plans today, mutual funds provide the most complete disclosure, including all of those items I just mentioned and much more. But required disclosure of this kind should not be limited to mutual funds. It should embrace, but does not today, every investment option available to workers in all defined contribution plans.

Now, fees are important, and they claim much of the attention in today's debate. It is a further indication of the success of the 401(k) system that workers investing in mutual funds have concentrated their assets in lower-cost funds. On average, 401(k) participants paid less than three quarters of 1 percent in mutual fund expenses in 2006. But fees are not the whole story. That is why a more complete approach to disclosure is vitally important. The low-cost option in the Enron 401(k) plan undoubtedly was Enron's own stock. It also turned out to be the most expensive. Focusing on fees alone could lead workers to make decisions that would hurt, not help, their retirement savings.

Money market mutual funds and stable value funds certainly have a place in one's portfolio. They are also low-cost options, but not ones best suited to long-term investment horizon.

Employers who sponsor plans also need effective disclosure. They should be informed of all payments that a service provider receives, whether directly from plan assets or indirectly from third parties. This will assist them, as fiduciaries, to judge the reasonableness of total fees and identify any potential conflicts of interest.

Finally, with respect to the servicing of 401(k) plans, a highly competitive market has given rise to different business models. In some plans, the employer itself, or a consultant on its behalf, assembles the needed components: recordkeeping, investment management, participant services, compliance, and so forth. In other plans, the employer engages a full service provider to supply all these services. A recent survey by Deloitte Consulting found that three quarters of plan sponsors used the full-service or bundled approach. This approach has many advantages: the employer incurs a lower cost of contracting, gains easy access to additional services, and can hold one party accountable for the quality of the service.

Now, some 401(k) recordkeepers, who bundle a part, but not all of the services required by a plan, want Congress to legislate their business model for the entire industry. They are seeking a law to require full-service providers to disclose separate prices for recordkeeping and investment management, even if both services are offered for a single fee. This is akin to a travel agent that only books airfare lobbying you to require its package tour competitors to break out hotel, transfers and other charges separately. We join numerous other organizations concerned about the success of the 401(k) system in urging you to reject this special pleading. The ICI looks forward to assisting the Committee and the Congress on these and other issues as you work to improve the Nation's retirement system. Thank you.

[The prepared statement of Mr. Stevens follows:]

Statement of Paul Schott Stevens, President and CEO, Investment Company Institute

My name is Paul Schott Stevens. I am President and CEO of the Investment Company Institute, the national association of U.S. investment companies,[1] which manage about half of 401(k) and IRA assets. The Institute has long called for effective disclosure to participants in individual account plans and the employers that

[1] ICI 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 ICI have total assets of approximately $11.339 trillion (representing 98 percent of all assets of U.S. mutual funds).

sponsor those plans. I want today to reiterate the mutual fund industry's support for rules giving participants and employers the information they need for the decisions they are required to make. We are pleased to testify before the Ways and Means Committee as it considers these important matters.

My testimony today will be as follows. First I will address how research looking at 401(k)s from various angles demonstrates the success and bright future of the 401(k) system. I will show that confidence in the 401(k) system is warranted and that under current regulations employers[2] and participants are able to make reasonable decisions in the areas in which they are called upon to act. I will then discuss how we can make the 401(k) system even better by addressing the gaps in current 401(k) disclosure and I will recommend principles that should guide reform. These principles, briefly stated, are that disclosure to participants should be simple, straightforward and focused on the key information, including but not limited to fees and expenses. This disclosure should apply to all investment products offered in 401(k) plans in a way that allows comparability. Finally, disclosure by service providers to employers should focus on the information employers need to fulfill their obligations as plan fiduciaries. Congress should not mandate rules to favor one business model over another.

Success of the 401(k) System

Growth in Retirement Savings

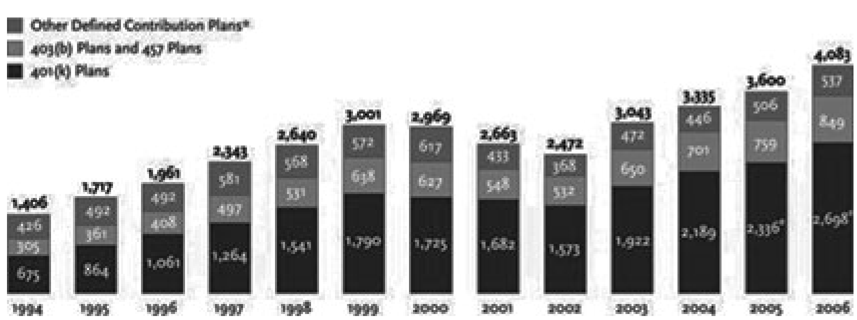
Any discussion of the 401(k) system should begin by recognizing how successful 401(k) plans have been in helping Americans save for retirement. Assets in the U.S. retirement system—all the tax-advantaged investments earmarked for retirement that supplement Social Security—have steadily increased as a share of household financial assets, from 12% of household financial assets when ERISA was passed in 1974 to nearly 40% at year-end 2006.[3] 401(k) plans, which have been around only 26 years, numbered 30,000 in 1985 and have grown to almost half a million plans (450,000) in 2006.[4] In 1985, there were about 10 million active participants compared with 50 million active participants now. 401(k) plans, which are now the predominant defined contribution plan, held $2.7 trillion in assets in 2006, which surpasses the assets held in all private defined benefit plans. The $2.7 trillion held in 401(k) plans does not count 401(k) assets that have been rolled into IRAs. In fact, estimates suggest about half of the $4.2 trillion in IRAs in 2006 came from 401(k) and other employer-sponsored retirement plans.

Critical Role of Mutual Funds

Mutual funds play an important role in 401(k) and similar defined contribution plans. At year-end 2006, slightly more than half of the $4.1 trillion held in all defined contribution plans—which include 401(k), 403(b) and 457 plans—were invested in mutual funds.

Defined Contribution Plan Assets and Amounts Held in Mutual Funds

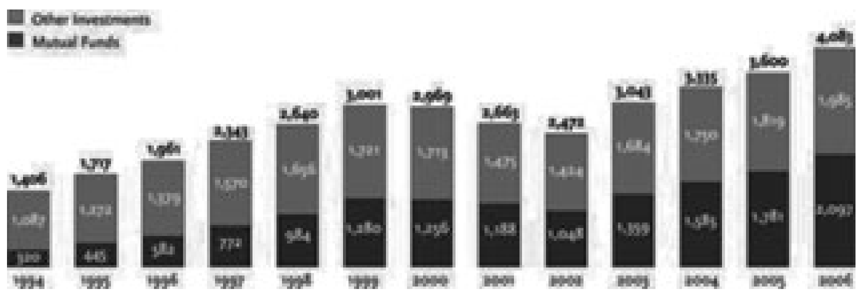
Billions of dollars, year-end, 1994–2006



[2] For convenience, we refer to "employer" to mean the employer acting in its role as fiduciary to the plan.

[3] See 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.

[4] 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).



e=estimated

Other defined contribution plans include Keoghs and other defined contribution plans (profit-sharing, thrift-savings, stock bonus, and money purchase) without 401(k) features.

Note: Components may not add to the total because of rounding.

Sources: Investment Company Institute, Federal Reserve Board, National Association of Government Defined Contribution Administrators, and American Council of Life Insurers

401(k) Participants Asset Allocation Varies with AgePercent of assets, year-end 2006

Overall, mutual funds represent about 55% of the assets in 401(k) plans, 53% of 403(b) plan assets, and 45% of 457 plan assets. These percentages have grown significantly over time relative to most other investment products. Both retirement savers and employers have come to rely on mutual funds because of the easy access to professional management, diversification, transparency, and liquidity.[5] The remaining assets in defined contribution plans are held primarily in pooled investment vehicles that are similar in many respects to mutual funds, including insurance company separate accounts, collective trusts, and stable value funds. Separately managed accounts, guaranteed investment contracts, and employer stock also are often available in 401(k) plans.

Ability of the 401(k) System to Provide Americans' Retirement Security

Some observers of the 401(k) system question the capacity of 401(k) plans to provide adequate retirement security. Some also question whether employers, acting as plan fiduciaries, obtain sufficient information to fulfill their obligations to keep plan costs reasonable and whether plan participants are equipped to make reasonable investment decisions for their accounts. Research by the Institute and others shows that these fears are largely unfounded.

It is commonly reported that the median 401(k) account balance is about $19,000.[6] Unfortunately, it is not commonly understood that the median account is not a meaningful number for assessing whether 401(k) savers will be prepared for retirement. By definition, the median account includes the newest and youngest participants (who are nowhere near retirement and whose accounts are understandably quite small) and those whose 401(k) accounts supplement a defined benefit plan. It does not account for employees who have 401(k) balances with both current and previous employers. Similarly, the median account balance does not reflect the $4.2 trillion held in IRAs. Finally, it is important to remember that the 401(k) system is still new enough that no one has had a full career with a 401(k) as the primary retirement savings vehicle.[7]

The Institute has undertaken extensive research on 401(k) plans. In a collaborative research effort, ICI and the Employee Benefit Research Institute (EBRI) cre-

[5] For example, in 1994, only about 27% of 401(k) assets were invested in mutual funds. See Brady and Holden, supra note 3.

[6] 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/per13-01.pdf.

[7] Many more individuals in today's workforce will have career-long exposure to 401(k) plans. Academic research shows a trend towards greater participation, especially among younger age groups. The participant rate for workers between 25 and 29 increased from about 50% in 1984 to close to 85% in 2003. See Poterba, Venti, and Wise, *New Estimates of the Future Path of 401(k) Assets*, NBER Working Paper, No. 13083 (May 2007).

ated the largest and most representative repository of 401(k) account data. At year-end 2006, our database includes information on 20 million participants in almost 54,000 employer-sponsored 401(k) plans, holding $1.2 trillion in assets.[8] The EBRI/ICI database, along with the extensive data we collect and analyze from mutual funds, allows us to examine the 401(k) system from many angles.

The 401(k) system warrants the confidence that Congress, employers, and American workers have placed in it. Even in today's workplace, where no one has had a 401(k) plan for a full career, the 401(k) system has demonstrated its savings power:

- 401(k) account balances rise considerably with participant age and tenure. For example, the average account balance for participants in their 50s with between 20 to 30 years of tenure is $174,272. Almost 50% of participants in this group have an account balance of greater than $100,000.
- Consistent participation builds and strengthens account balances and allows participants to weather bear markets. When we examined consistent participants in the EBRI/ICI database—those who held an account balance at least during the seven-year period from 1999 to 2006 (which included one of the worst bear markets for stocks since the Great Depression):
  - The average 401(k) account balance increased at an annual growth rate of 8.7% over the period, to $121,202 at year-end 2006.
  - The median 401(k) account balance increased at an annual growth rate of 15.1% over the period, to $66,650 at year-end 2006.
- Participants also generally use their 401(k) accounts for their intended purpose—providing income in retirement.[9] In 2000, ICI surveyed recent retirees about their distribution decision from a defined contribution plan.[10] One-quarter deferred some or all of the distribution, leaving a balance in the plan. About one-quarter received an annuity, and about 10 percent chose installment payments. About half of the recent retirees took a lump-sum distribution of some or all of their balance.[11] Of those that took a lump-sum distribution, 92 percent of respondents said they reinvested all or some of the proceeds, in most cases in an IRA. Only 8 percent spent all of the proceeds. Those who spent all of the proceeds tended to have small distributions. In most instances, the proceeds were used for practical purposes, such as a primary residence, debt repayment, healthcare, or home repair.

We also have examined in collaboration with EBRI whether a full career with 401(k) plans can produce adequate income replacement rates at retirement.[12] The EBRI/ICI 401(k) Accumulation Projection Model examines how 401(k) accumulations might contribute to future retirees' income based on decisions workers make throughout their careers. The model looks at participants of varying income levels, modeling future accumulations under a range of market outcomes and using typical (and often imperfect) individual behaviors. For example, among individuals who were in their late twenties in 2000, after a full career with 401(k) plans, the median individual in the lowest income quartile is projected to replace half of his or her income using 401(k) accumulations. Social Security replaces the other half for the median person in this quartile. The model also demonstrates that when workers move into jobs that do not offer a 401(k) plan, median replacement rates fall significantly—by about half for workers in the lowest income quartile. In short, the worst thing that can happen to a worker is to be in a job that does not offer retirement savings plan coverage.

---

[8] See Holden, VanDerhei, Alonso and Copeland, supra note 6.

[9] Participants' loan activity is modest. In 2006, only 18 percent of 401(k) participants eligible for loans had taken one. On average the loans amounted to only 12 percent of the remaining account balance. See Holden, VanDerhei, Alonso and Copeland, supra note 6.

[10] Investment Company Institute, *Financial Decisions at Retirement*, ICI Fundamentals, vol. 9, no. 6 (November 2000), available at http://www.ici.org/pdf/fm-v9n6.pdf.

[11] These percentages add to more than 100 percent because some respondents with multiple options chose to receive a partial lump-sum distribution with either a reduced annuity or reduced installment payments, or chose to defer receiving part of the proceeds. See Investment Company Institute, supra note 10.

[12] 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.

Decision Making by Participants and Employers

Our research suggests that under the current 401(k) regulatory system participants and employers have been able to make reasonable decisions in the areas in which they are called upon to act. Our research with EBRI has demonstrated that participants generally make sensible choices in investing their accounts. For example, older participants have a lower concentration in equities compared with participants in their twenties and a greater concentration in fixed-income securities.

401(k) Participants Asset Allocation Varies with Age

Percent of assets, year-end 2006

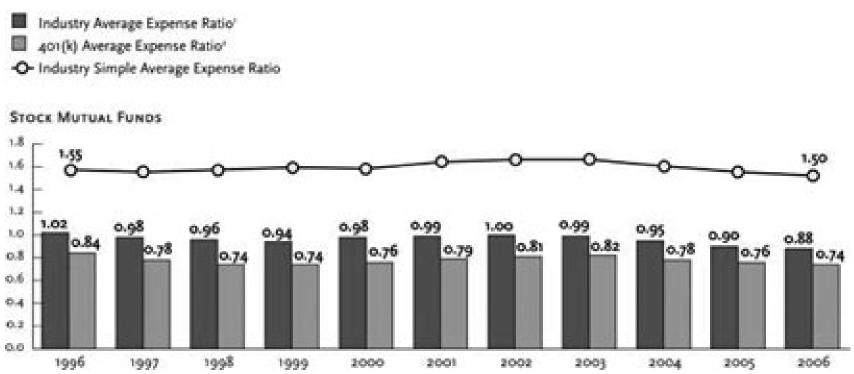
**Includes mutual funds and other pooled investments.*

Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project

Research also suggests that both employers and participants are cost conscious when selecting mutual funds for their 401(k) plans. The Institute has combined our extensive research on trends in mutual fund fees with our tracking of 401(k) plan holdings of mutual funds.[13] 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.

401(k) Mutual Fund Investors Tend to Pay Lower-Than-Average Expenses

Percent of assets, 1996–2006



[1] *The industry average expense ratio is measured as an asset-weighted average.*

[2] *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.crsp.com); Primary datasource; and Strategic Insight Simfund

---

[13] 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.

We found that 401(k) savers tend to concentrate their assets in lower-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% at year-end 2006. 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 category 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.[14]

There are several factors that contribute to the relatively low average fund expense ratios incurred by 401(k) plan participants.[15] Employers, acting as plan fiduciaries, 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 employers and employees in selecting investments for their accounts.

Improving Disclosure

The employer-based 401(k) system has been a great success and has a bright future, but we also agree that it is time to ask whether we can build on the system to make it even better. Congress took a big step in the Pension Protection Act of 2006 by codifying into law the automatic, or autopilot, 401(k) plan, with appropriate default investments designed for long-term saving.[16] In the Institute's view, the 401(k) system could be further strengthened with appropriate disclosure reform.

Meaningful and effective disclosure to 401(k) participants and employers remains an Institute priority. In 1976—at the very dawn of the ERISA era—the Institute advocated "complete, up-to-date information about plan investment options" for all participants in self-directed plans.[17] We also have consistently supported disclosure by service providers to employers about service and fee arrangements.[18] In January 2007, the Institute's Board of Governors adopted a Policy Statement on Retirement Plan Disclosure that reaffirms and chronicles the Institute's long record in support of better disclosure.[19] The Policy Statement calls upon the Department of Labor to require clear disclosure to employers that highlights the most pertinent information, including total plan costs, and to require that participants in all self-directed plans receive simple, straightforward explanations about the key information on each of the investment options available to them, including information on fees and expenses.

Current Gaps in Disclosure Rules

Fundamentally, there are two gaps in the current 401(k) disclosure rules. First, the Department of Labor's rules produce unequal disclosure to participants. The Department of Labor's rules cover only those plans relying on an ERISA safe harbor (section 404(c)); no rule requires that participants in other self-directed plans receive investment-related information. In plans operating under the safe harbor, the information participants receive depends on the investment product. Participants receive full information on products registered under the Securities Act of 1933, such as mutual funds, because the Department requires that participants receive the full SEC-mandated prospectus. For other investment products, such as bank collective trusts and separately managed accounts, key information, including 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. This disclosure

---

[14] These expense ratios include any payments a fund makes to recordkeepers to defray the cost of 401(k) plan administration.

[15] 401(k) investors in mutual funds also tend to hold funds with below-average portfolio turnover, which also helps keep down the costs of investing in mutual funds through 401(k) plans. See Holden and Hadley, supra note 13.

[16] Academic research demonstrates the power of automatic enrollment to increase participation rates, particularly among lower income workers. See Choi, James J., David Laibson, Brigitte Madrian, and Andrew Metrick, *For Better or For Worse: Default Effects and 401(k) Savings Behavior*, NBER Working Paper, No. 8651 (December 2001); and Madrian, Brigitte C., and Dennis F. Shea. *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, NBER Working Paper, No. 7682 (May 2000).

[17] Letter from Matthew P. Fink, Associate Counsel, Investment Company Institute, to Morton Klevan, Acting Counsel, Plan Benefit Security Division, Department of Labor (June 21, 1976).

[18] 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/tmny/04_dol_krentzman_tmny.html.

[19] See http://www.ici.org/pdf/ppr_07_ret_disclosure_stmt.pdf.

gap is particularly important because many 401(k) plans use pooled products that look and operate much like mutual funds, but which do not have disclosure requirements comparable to SEC requirements. The ERISA Advisory Council recently found that while mutual funds are the "easiest investment to understand," they have the "heaviest burden" when it comes to disclosure and "less regulated and harder to understand investments might not even provide information regarding fees and performance." [20]

The second gap in current rules is that there is no specific requirement on service providers to disclose to an employer information on services and fees that allows the employer to determine the arrangement is reasonable and provides reasonable compensation. The Institute supports disclosure of payments a service provider receives directly from plan assets and indirectly from third parties in connection with providing services to the plan. Information on direct and indirect compensation allows employers to understand the total compensation a service provider receives under the arrangement. It also brings to light any potential conflicts of interest associated with receiving payments from another party, for example, when a plan consultant receives compensation from a plan recordkeeper.

Efforts Underway to Improve Disclosure Rules

The Department of Labor is taking steps to enhance 401(k) plan disclosure. As Assistant Secretary Bradford Campbell testified before the House Education and Labor Committee and the Senate Aging Committee, the Department of Labor has a three-pronged regulatory agenda to improve fee disclosures to participants, plan fiduciaries, and the government.[21] These projects, in various stages of regulatory development, are intended to close the disclosure gaps described above. In addition, both Chairman George Miller and Subcommittee Chairman Richard Neal have introduced legislation (H.R. 3185 and H.R. 3765, respectively) addressing disclosure in the 401(k) and defined contribution market.

Principles for Disclosure Reform

Initiatives to strengthen the 401(k) disclosure regime should focus on the decisions that plan participants and employers must make and the information they need to make those decisions. The purposes behind fee disclosure to employers 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 to the neglect of other important information, such as investment objective, historical performance, and risks. On the other hand, employers, as fiduciaries, must consider additional factors in hiring and supervising plan service providers and selecting plan investment options. Information to employers should be designed to meet their needs effectively. Finally, disclosure reform should be carefully considered so as to avoid imposing unnecessary costs, which often are borne by participants.

1. Participants in all self-directed plans need simple, straightforward disclosure focusing on key information, including information on fees and expenses.

Our extensive research into the information that mutual fund investors prefer and use in making investment decisions tells us that shareholders do not consult fund prospectuses or annual reports, which they find too long and difficult to understand. This is especially true among shareholders with less education: 75% of mutual fund shareholders with less than a four-year college degree say that a mutual fund prospectus is very or somewhat difficult to understand.[22] Overwhelmingly (80%), shareholders prefer a concise summary rather than a detailed description. In making a fund purchase, mutual fund shareholders take into account certain key factors, in-

---

[20] 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.

[21] See Written Testimony of Assistant Secretary of Labor Before the Committee on Education and Labor (October 4, 2007), available at http://edworkforce.house.gov/testimony/100407BradfordCampbellTestimony.pdf. See also Written Testimony of Assistant Secretary of Labor Before the Special Committee on Aging (October 24, 2007), available at http://www.dol.gov/ebsa/newsroom/ty102407.html.

[22] Investment Company Institute, *Understanding Investor Preferences for Mutual Fund Information* (2006), available at http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf. The Institute surveyed 737 randomly selected fund owners who had purchased shares in stock, bond, or hybrid mutual funds outside workplace retirement plans in the preceding five years.

cluding the historical performance (69% of investors considered this), fund risk (61%), types of securities held by the fund (57%), and the fees and expenses (74%).

Based on this research, we believe that 401(k) participants should receive the following key pieces of information for each investment product available 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
- Identity of the investment adviser that manages the product's investments

Participants also need information about the plan fees that they pay, to the extent those 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). Disclosure reform should also leverage cost-effective new technologies like the Internet.

Fees and expenses are only one piece of necessary information and must be disclosed in the context of other key information. The lowest fee option in many plans is the option with relatively low returns (such as the money market fund) or relatively higher risk (such as the employer stock) but it is not appropriate for most employees to invest solely in these options. For example, any disclosure of fees associated with employer stock also should describe the risks of failing to diversify and concentrating retirement assets in shares of a single company. In short, it is not enough to tell participants that fees are only one factor in making prudent investment decisions—they must be shown this by presenting fees in context.

Streamlining disclosure to mutual fund investors to focus on key information is underway at the Securities and Exchange Commission.[23] 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.

2. Disclosure should apply to all investment products regardless of type in a way that allows comparability.

Any disclosure reform must ensure that participants receive basic information that allows them to evaluate and compare all investment options available under the plan. Disclosure of the key information we recommend 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 of these options should disclose the operating expenses of the fund or account. 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 also 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, for example, the risks of interest rate changes, the long-term risk of inflation, and the risks associated with the product provider's insolvency.

[23] See Statement of 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. 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).

3. Employers should receive clear information about plan services and fees, including total costs, that allows them to fulfill their fiduciary duties.

Employers should receive 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 third parties in connection with providing services to the plan. These payments from third parties, sometimes inaccurately referred to as "revenue sharing" but which are really cost sharing, often are used to defray the expenses of plan administration. We support requiring their disclosure by service providers.

ERISA imposes clear responsibilities on employers, in their roles as fiduciaries, in entering into any service arrangement. Under ERISA section 404(a), fiduciaries 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 no more than reasonable compensation is paid for a contract for services. 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. Effective disclosure by service providers to employers is essential to enabling employers to enter into and maintain reasonable 401(k) service arrangements.

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 under the plan. The recordkeeper is compensated for its services to the plan, in whole or in part, by asset-based fees paid in connection with the plan's investment choices, which can either be proprietary or third party investment products. The Department of Labor has stated that "many of these arrangements may serve to reduce overall plan costs and provide plans with services and benefits not otherwise affordable."[24]

There are several reasons plans use asset-based fee arrangements. Using asset-based fees to cover administrative services 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, maintaining shareholder accounts, and sending shareholder statements. Because mutual funds charge asset-based fees, shareholders with larger accounts subsidize those with smaller accounts. Similarly, wrap fees in separately managed accounts or other brokerage accounts and M&E charges in insurance products mutualize certain costs in those products.

In plans, asset-based fees allow new participants and those with lower wages or smaller accounts to participate without their fixed share of administration costs falling disproportionately, as a percentage of account balance, on them.[25] Asset-based fee arrangements also help pay for plan start-up or service provider transition costs, which can be significant. To avoid the plan incurring all those expenses in the first year, asset-based fees allow a provider to recoup its expenses over several years as plan assets grow.

There are practical reasons why plans, especially smaller plans, contract with one party—a recordkeeper—to receive all the services the plan requires. Using a single full-service provider to obtain administrative services and access to plan investments eliminates the cost to an employer 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.[26] In many of these arrangements, a service provider offers access for plan clients to its proprietary mutual funds, or bank or insurance products.

We recommend that a service provider that offers a number of services in a package be required to identify each of the services and the total cost, but not to break out separately the fee for each of the components of the package. If the service provider chooses not to offer services separately, requiring the provider to assign a

---

[24] Testimony of Robert J. Doyle, Director of Regulations and Interpretations, Employee Benefits Security Administration, Before the Working Group on Fiduciary Responsibilities Update and Revenue Sharing, Advisory Council on Employee Welfare and Benefit Plans (July 11, 2007).

[25] For example, if a plan has $50 annual per-participant fixed cost and charges every participant the same $50 charge, a new or lower-paid participant with an account balance of only $1000 would pay 5% of his or her account balance in administration fees in a year. A participant with an account balance of $100,000 would only pay 0.05% of his or her account balance. "Mutualizing" the fixed cost by charging, for example, every participant 0.1% of his or her account, can help encourage participation by new and lower-income workers.

[26] 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.*

price to the component services will produce artificial prices that are not meaningful to the employer in making comparisons. Many products and services are "bundles" of individual components that might not be offered separately at the same total price. So-called "package" vacation tours—often including airfare, hotel, ground transportation and entertainment and amenities all for a single price—are examples of bundled services. Components of the package are not separately priced, are more easily and conveniently secured as a group, and typically cost less in total than they would if purchased individually. Nonetheless, consumers can, and do, shop for vacations on an unbundled basis.

If a recordkeeper offers to provide participant accounting, compliance services, and participant communications in a single package, it should not have to attribute separate fees to those components. Similarly, if a provider offers proprietary investment products as well as recordkeeping, it should not be required to price these separately if they are offered as a package for a total cost that is disclosed.

In economic terms, products and services are bundled together because the provider believes it is efficient to do so, and it would not be efficient to track and disaggregate accurately the cost of any one component. Any attempt to "price" each component would be artificial. Mutual fund organizations are able to provide 401(k) administrative services efficiently in part because some of these services are similar to those they already provide to retail shareholders of their own funds.

Proposals to Favor One Business Model

One trade group whose members bundle many, but not all, of the 401(k) service components offered by other providers has asked Congress to mandate rules to favor its members' business model. The American Society for Pension Professionals & Actuaries (ASPPA), along with its subsidiary, the Council of Independent 401(k) Recordkeepers, has asked Congress to mandate that service providers offering proprietary investment options disclose to employers a price for recordkeeping and administration and a separate price for investment management, even if this "price" has to be generated artificially and thus will be of questionable accuracy.[27] This approach favors one business model—firms that just bundle together recordkeeping and other administrative services—over another business model—firms that offer recordkeeping and administration as well as investment management services, by imposing additional disclosure burdens on the full-service model.

All 401(k) recordkeepers bundle together a variety of recordkeeping services, including transaction processing, participant statements, web access, and participant education. ASPPA's recommendation is not that Congress mandate unbundling the price for the wide variety of administrative services its members provide. Rather, ASPPA seeks unbundling of investment management expenses from administrative and recordkeeping fees by providers that offer proprietary products.

Numerous stakeholders, including those representing employer groups, service providers, and investment providers, have urged Congress not to mandate this unbundling.[28] This disclosure is unnecessary, artificial, and would favor one business model over another. The breakout of investment management and recordkeeping expenses is not required by ERISA. As the Department of Labor has made clear, the key for plan fiduciaries is to compare the total cost of recordkeeping and investments of one provider with the total costs of recordkeeping and investments of another provider or group of providers.[29]

---

[27] See Testimony of Tommy Thomasson on behalf of American Society of Pension Professionals & Actuaries and the Council of Independent 401(k) Recordkeepers Before the U.S. House Education and Labor Committee (October 4, 2007).

[28] For example, see Testimony of Lew Minsky on behalf of the ERISA Industry Committee, the Society for Human Resource Management, the National Association of Manufacturers, the United States Chamber of Commerce, and Profit Sharing/401k Council Of America Before the U.S. House Education and Labor Committee (October 4, 2007); Testimony of Robert G. Chambers on behalf of the American Benefits Council, the American Council of Life Insurers and the Investment Company Institute Before the U.S. Senate Special Committee on Aging (October 24, 2007).

[29] The Department of Labor's model "401(k) Plan Fee Disclosure Form" encourages employers to ask about the services included in a bundled arrangement, and the total cost, but does not require that the "price" for each service be disclosed. See http://www.dol.gov/ebsa/pdf/401kfefm.pdf. The Department of Labor states in its just released "ERISA Fiduciary Adviser" interactive web tool: "In comparing estimates from prospective service providers, ask which services are covered for the estimated fees and which are not. Some providers offer a number of services for one fee, also called a ?bundled' services arrangement, while others charge separately for individual services. Compare all services to be provided with the total cost for each provider." See http://www.dol.gov/elaws/ebsa/fiduciary/q4g.htm. See also "Meeting Your Fiduciary Responsibilities," http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html.

Conclusion

We applaud the Committee for examining this important topic and once again thank you for providing the Institute this opportunity to testify. We look forward to continuing to work with this Committee and its staff in these and other matters of importance to funds and their shareholders.

Mr. MCDERMOTT. Thank you very much for your testimony. I sort of imagine myself being a member of the public sitting and listening to this and realizing that their pension is being determined by this kind of a discussion. How many of you handle unbundled services? How many of you handle bundled services? So, we have got one here. Now, I think in the free enterprise system we think that competition is good, nobody ever has inferred that we should not have competition, how can you have competition without full disclosure of all the fees? How do you have that? I would like to hear some discussion from you about how anybody could argue against us having regulations that require everything to be disclosed because the government plans have it, and they are in the bidding prospect. When they go for our Thrift Savings Plan, that whole thing is there, so they are competitive. Yes?

Mr. THOMASSON. Thank you, Congressman. I will say that as a representative of the Council of Independent 401(k) record keepers and also the president and CEO of DailyAccess Corporation, we are an unbundled, or what is termed in the definition of this hearing, as an unbundled provider. Actually, we totally agree with exactly what you just said, how can anyone have a decisionmaking process for buying or purchasing anything, services, products or anything, without disclosure of what is involved in those products or services. I also speak on behalf of my own plan, the DailyAccess Corporation 401(k) plan and trust, I am the fiduciary of that plan. I also happen to be in a reasonable position to understand a little bit about what this debate is regarding, and I still have trouble with other services that we are buying from other people determining what type of fees are associated, and I am a trained fiduciary. I have outside training regarding my fiduciary responsibility. Without full fee disclosure, competition does suffer.

In my oral testimony, we talked about certain business models being able to claim that services on a bundled basis were free in certain cases, in certain circumstances and that is not exactly true. So, full fee disclosure does enable competition.

Mr. MCDERMOTT. I heard the lawsuit business here. Now, there are some contentious employees out there who may bring a lawsuit on their employer. If their employer knows that the bundled fees are being slipped through on to the plan participant, the employee, and does not tell him that, does he get liability in that regard or she? Can they be sued for that?

Mr. MINSKY. Well, Congressman, you can be sued for anything.

Mr. MCDERMOTT. I know. That was a lawyer's answer. Come on, I am not a lawyer, let's talk here.

Mr. MINSKY. I think that the fair question is what is the responsibility of the plan fiduciary to determine what costs are out there, and I guess I would differ from Mr. Thomasson a little bit in saying that I think I would frame the issue as one of transparency, not one of bundled versus unbundled. I think that a plan sponsor who is acting as fiduciary has a responsibility to make sure that the total fee for what they are buying is reasonable, and ERISA provides that obligation and so to the extent they do not comply with it, they have potential liability. But on the other hand, I think a plan fiduciary can comply with that responsibility without breaking out services that are not naturally broken out.

Mr. MCDERMOTT. Can the fiduciary have information that I as the employee do not have?

Mr. MINSKY. Yes, I think, as we have heard from the last panel and I think you would hear consistently on this panel, there is some information that a plan sponsor, as a buyer of services, needs to have that is not necessarily relevant to the decision that a plan participant makes, which is, one, whether or not to participate in the plan; and then, two, if they decide to participate in the plan, which investment option from those available or which options is best for that participant. So, yes, I do think that there are some things that the plan fiduciary, who is negotiating the service contract needs, that may not be beneficial for the participant.

Mr. MCDERMOTT. That may not be beneficial? Yes, Mr. Thomasson?

Mr. THOMASSON. Thank you, Congressman. Mr. Minsky and I do agree that the issue is not bundled versus unbundled, it is one of uniformity. It is not about the business model, it is about plan sponsors as fiduciaries and the participants that they serve. So, how can a fiduciary not want more disclosure? Look at what the general public does when they go buy a car or they go on a trip?

Mr. MCDERMOTT. Buy a mortgage.

Mr. THOMASSON. Or a mortgage, they want to know as much detail about those decisions as they can even though they do want to know the total cost ultimately, but what are the decisions that they have to make, what are the cost components underneath it that they may be able to do something different with? It is the same thing. If you are fiduciary and you are handling money and making decisions for your employees retirement, how do you not ask for information from that perspective. So, we do agree that it is not bundled/unbundled, it is not about a business model.

Mr. STEVENS. Mr. Chairman, could I respond?

Mr. MCDERMOTT. Yes.

Mr. STEVENS. It occurs to me that you can think about this in very simple terms. You have got two grocery stores on your block. You want to buy two apples. You can buy one from each at five cents each, and now you know you have got two apples for 10 cents. Or you can go to one store and get both for 10 cents. The important thing is for the fiduciary to know what services are being received and what costs are being incurred for them. The reason that there is a preference is because going to a single provider makes life simpler for the thousands and thousands of small businesses who try to sponsor and run 401(k) plans.

But I think it is important to add that Mr. Thomasson's organization has been on both sides of this issue. In February 2005, there was a submission by ASPPA to the Labor Department that said, "We do not believe it is necessary or appropriate for each specific fee or expense item to be separately disclosed so long as the total costs payable out of the plan assets are disclosed." That is our position. It was ASPPA's position just 2 years ago.

Mr. THOMASSON. I would really love to respond to that, Congressman.

Mr. MCDERMOTT. As the Chairman, I should not, but I will let you answer that, and then we are going to move on.

Mr. THOMASSON. Thank you, sir. Mr. Stevens and I do agree that, yes, our position a few years ago to Labor was that response. You know, quite frankly, the two ends of this table are not really on different sides of the fence. This argument is really related to one thing, that is uniformity of disclosure. The reason we are having a problem here is because of different business models not wanting to disclose what their model differences are versus others.

Now, in our testimony to Labor, we did talk about the break out of fees and components, but we were also coming from this, coming at the argument from the standpoint of independent unbundled providers. It is natural for us to actually illustrate what our fees for our services are. That is the side of the business that we come from. So, we are not actually in opposition with Mr. Stevens in his opinion. It is about the same argument. We are all looking for the same thing, uniformity of disclosure.

By the way, one other thing, it is easy to deal with an independent unbundled provider as well because there is usually one source of contact for that model, just like there is for a bundled model. Thank you, sir.

Mr. MCDERMOTT. Mr. Herger? I apologize to the Committee for stepping on my prerogatives.

Mr. HERGER. Thank you, Mr. Chairman. For Mr. Jackson, are fees for small plan sponsors generally higher or lower than for large sponsors?

Mr. JACKSON. I am not an expert on that subject because I have never looked at it from the perspective of a large employer. I can tell you that we did shop, and we looked at bundled and unbundled packages. I am not an expert on 401(k)s, what I wanted to know was what is the total cost given my number of employees, my number of assets, and I feel that we got a good deal based on that shopping model without me knowing the breakdown of all of the various fees that went into that component. I was looking for the best overall cost.

Mr. HERGER. Following up, is there a risk that additional legislative requirements could translate into an even greater burden for small businesses or worse, a decision by some businesses not to offer a 401(k) plan?

Mr. JACKSON. That is certainly a concern that I have. It was a struggle for us to make the reach to go to a 401(k), and I do not have any statistics in front of me, but I would suggest that there are a few percentage of companies that have 25 and fewer employees that do have a 401(k) and the more burden you put on it, the fewer you are going to have.

Mr. HERGER. In considering whether to sponsor a retirement plan for their workers, what concerns did small businesses express with respect to their fiduciary obligations and the possibility of lawsuits?

Mr. JACKSON. Well, certainly that is always a concern. While we are at a disadvantage in terms of not being a major player in the market in terms of providing the best price, we do have an advantage, and I can sit in a room with all 25 of my employees and get their input and discuss it and make them a part of the decisionmaking process, which I understand in a large company would not be a practical answer.

So, yes, there is concern about lawsuits, but I think as long as we are trying to do the best thing that we can for our employees, I would point out that contributions do not require a matching contribution from the employee, so anything they get is above and aboard for them. But we designed the program to help us attract employees, that is one of the reasons for going to it.

Mr. HERGER. Mr. Minsky, are you considering that too much focus on plan fees may have the unintended effect of discouraging employers from sponsoring retirement plans or discouraging workers from participating in them?

Mr. MINSKY. I very much do. I think it likely could do that. I think also for people who continue to participate in plans, I am concerned that an over focus on fees means an under focus on other important issues and ultimately might lead to poor decisionmaking. A participant who is focused only on fees may select investments that ultimately do not lead to their long-term best interest.

Mr. HERGER. So, you could have a plan that maybe is doing better out there, making more money, even if its fees were a little higher, it would ultimately give the employee far more money than one with lower fees that was not doing as well?

Mr. MINSKY. Yes, I was struck by the comment earlier about the plan or the account that has 1 percent higher fees ultimately leading to 7 percent less retirement savings at the end of the day and thought, well, if that same plan account had 2 percent higher return, it would actually lead to 17 percent higher balances at the end of the day, so I think fees alone are not the right analysis.

Mr. HERGER. Fees are certainly important, but probably far more important is the point that you just made.

Mr. MINSKY. The total return.

Mr. HERGER. What trends are occurring even without legislative action to increase transparency of plan fees?

Mr. MINSKY. I can speak first and foremost about in the large plan market and tell you that I have been interacting with our service providers for several years and the level of transparency that we receive has changed significantly over that time period, to a point where I am very comfortable today saying that our relationship with our service providers is completely transparent. I think that that same thing cannot be said for smaller plans at this point, but I see the trend continuing and slowing down, and I think the advancements made by Honeywell and my company and other large companies are starting to be felt by smaller companies and ultimately the market is getting there.

Mr. HERGER. Thank you. Thank you, Mr. Chairman.

Mr. MCDERMOTT. Thank you. Mr. Neal will inquire.

Mr. NEAL. Thank you, Mr. Chairman. Mr. Thomasson, I appreciate your kind comments and your testimony regarding my bill on fee disclosure. I agree with you that both bundled and unbundled providers should be disclosing their fees. As you suggested in your testimony, it need not be item by item, but it can be done in broad categories and that is precisely what my legislation mandates. We have heard some testimony today though that says it is not possible for bundled providers to break out major categories of cost. My staff has given you a copy of a sales proposal from a great Massachusetts-based provider, Fidelity, comparing their cost to a competitor, which breaks out recordkeeping costs from expense ratio. Can you discuss how this type of information helps a small businessowner make decisions about their employees' retirement plan?

Mr. THOMASSON. Yes, sir, thank you, Congressman Neal. To answer the question fairly directly, the more information a fiduciary has regarding the selection of services for their participants in a plan that they would provide, there are an enormous number of details that are involved in how you process a plan. We know it, every other provider knows it, anybody that provides operations. So, what is relevant to a decisionmaking process is the summary of three main categories, which are investments, the investment expense, the management expense, it costs money to manage money, nobody is arguing that concept, it costs money to operate a plan for the generation of participant statements, recordkeeping, administration, trust, custody trading, all the operational components that are the same regardless of business model, and then any selling or advisory fees or outside third party fees that are associated with delivering services to that plan that may be compensated from plan assets or via some other mechanism. Those three categories will enable fiduciaries to make reasonable apples to apples comparison amongst providers.

One of the basic premises that we are arguing here is business model differences should dictate non-uniformity of fee disclosure. Well, if you have specific categories under that disclosure scenario that are uniform across the marketplace, than fiduciaries of every plan size, small and large, will be able to differentiate between providers and the services that they are paying for.

Mr. NEAL. Mr. Minsky, you seem to place great faith in the Department of Labor and the regulatory process, indicating that whatever they do must be satisfactory. Are you prepared to say today that you will forfeit any effort down the road to seek legislative relief if, in fact they, come back with a bad proposal?

Mr. MINSKY. No, Congressman, not at all.

Mr. NEAL. Are you saying you might shop for the best deal?

Mr. MINSKY. I am not saying that either. What I am saying is that I think the DOL is first of all well advanced in their initiatives, my hope is that they will get guidance out relatively soon. That I think the best approach for Congress is to wait and see what DOL does and if what DOL does is satisfactory, great. If not——

Mr. NEAL. Emphasis on the word "guidance"?

Mr. MINSKY. Say it again, I am sorry?

Mr. NEAL. Are you emphasizing the word "guidance," that Congress ought to wait and seek guidance from the Department of Labor on this issue?

Mr. MINSKY. No, no, what I am saying is I think the regulatory process by its nature is more flexible and ultimately will be the better avenue for these important and difficult issues to be addressed. However, it is obviously Congress' prerogative after—at any point, but particularly after the DOL acts, to wait and see and if DOL does not get the job done——

Mr. NEAL. Is it your prerogative to visit with your local Member of Congress to seek relief afterward if you do not like the proposal that DOL offers?

Mr. MINSKY. Obviously, that is part of the political process.

Mr. NEAL. Well, thank you. Ms. Klausner, we have heard your testimony today that regulations in this area might not come until late 2008 or beyond. Many of us feel that there is a need to act sooner, and that our companies and workers expect some movement toward greater disclosure. You and I have discussed my approach, more disclosure in broad, general categories. Is this something you think that companies and vendors can work with?

Ms. KLAUSNER. I do think it is something that vendors and plan sponsors can work with. I have found that your bill is one which nicely lays out a difference between the dialog between plan service providers and plan sponsors and the dialog from plan sponsors to the participants. I think that that framework can be utilized in concert or cooperation ultimately with either working with Mr. Miller and his group to come out with a total bill package that is satisfactory to all Members, as well as listening to the guidance that comes out of the Department of Labor and seeing whether there can be some cooperation between all the different avenues of getting to the right result, which ultimately for all of us is excellent retirement savings and an understanding about the usefulness of a 401(k) plan.

Mr. NEAL. So, you maintain that the process ought to remain fluid?

Ms. KLAUSNER. Absolutely, the process should be fluid, it should be cooperative. What we do not want is for any Member of either Congress or the Department or plan sponsors or plan service providers to feel that they have sole ownership of the ability to find the right answer.

Mr. NEAL. Thank you very much. Thank you, Mr. Chairman.

Mr. MCDERMOTT. Mr. Pomeroy will inquire.

Mr. POMEROY. Thank you, Mr. Chairman. I think that the testimony today has been very interesting, and it is my hope that by the time we are done working on this, we will have a clear disclosure format that really is one that the bundled and unbundled community can alike find merit in that is going to have value to plan participants. Having said that, I want to get back on the defined benefit issue because this is the only chance really that we have to talk about it. I value having the opportunity to question two significant employers in terms of what they are thinking about in terms of funding of questions with so many unknowns even as the new year and the new requirements will begin. So, I would ask Allison and then Lew, if you would, to talk about your commitment—do you have a defined benefit plan, what is your ongoing commitment to it? Do the questions about plan funding leave you anxious about whether or not you will be able to continue to support both the DC and DB plan?

Ms. KLAUSNER. Thank you, Mr. Pomeroy. Honeywell does have a significant defined benefit plan and other smaller defined benefit plans within its universe. At this point in time, we are committed to maintaining both a defined benefit plan, as well as our defined contribution plan. I personally do not work on a regular basis in the defined benefit community, my colleague does, but I understand from both Honeywell and other members of the American Benefits Council that we continue to support the types of plans, that we do support a 1 year delay of the PPA funding rules, which I know are of great interest to you.

Mr. POMEROY. I absolutely believe we need—plan funding has improved based on this mark to market evaluation. Let's just put this on hold for a year, we have done that with other pieces of legislation, and make certain we get the implementation right because if we get the implementation wrong, we may cause perfectly fine plans to be frozen rather than have the employers deal with the many uncertainties about continuing them. I appreciate very much your comment in support of a 1 year delay. I would ask Lew?

Mr. MINSKY. Thank you, Congressman. FPL Group does sponsor a defined benefit plan, and we are committed to providing retirement security to our employees through both a defined benefit and defined contribution plan going forward. The funding issues are somewhat unique in our company because we have an extremely well-funded pension plan and are not anticipating any funding obligations in the near future. That said as a public policy matter, I agree wholeheartedly with the points you made earlier and if we were in a position where funding was a real prospect in the short term, it would be very difficult going forward not knowing what the rules would be.

Mr. POMEROY. Within the ERISA Industry Committee, are you familiar with other members and what their thinking might be on this?

Mr. MINSKY. Yes, well, having been at the ERIC board meeting recently, this was a popular topic, and I think there is a fair amount of concern and uncertainty about moving forward without a clear understanding of what the rules are.

Mr. POMEROY. This week's Pension and Investments Magazine has an article about the former head of PBGC, who is now working for a hedge fund that wants to pick up frozen pension plans and manage them. Now would you feel comfortable as a business that your fiduciary responsibility to plan participants would pass entirely to the hedge fund in such a laying off proposal, Mr. Minsky?

Mr. MINSKY. I think that would depend largely on what type of framework was set up in order for that transfer to be made. This is outside of the area I came to talk about, but I think it would be difficult in the current regulatory scheme to do that, although I understand it is quite common in the UK, and they have a slightly different scheme. I think ultimately that is something that Congress may want to look at and something the DOL and the PBGC may look at more carefully. It is probably not something that is in the purview of my expertise.

Mr. POMEROY. Well, I think you have teed up the issues nicely. I want to put a copy of this article into the record, and I would further add I have got serious questions about this. My own notion is you cannot just simply shed your fiduciary responsibility to plan participants by transferring basically a plan to have them run off the assets. It also leaves in my own mind a very strong impression that this former PBGC official knows darn well these frozen pension plans are probably well funded on a realistic mark to market approach and that is why they are so comfortable taking on plan liabilities with the assets that the plan has to support them. In any event, I do not think anyone should be of the impression that Congress or the Administration is going to sit quietly by while these things just go willy nilly into the hedge funds without any government action taken, so thank you, Mr. Chairman, I will add this for the record.

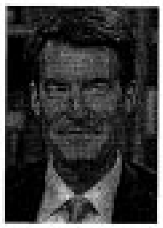
[The information follows:]

Pensions&Investments
PIonline.com
The international newspaper of money management October 30, 2007

Ex-PBGC chief seeking frozen plans

Belt's new firm sees business opportunity through careful management of assets, liabilities

By Doug Halonen
Posted: October 29, 2007, 6:01 AM EST



Jamie Rector/Bloomberg News
Brad Belt is talking to regulators, plan sponsors and money managers to gain support for his proposal.

WASHINGTON — Bradley D. Belt, the former Pension Benefit Guaranty Corp. chief, wants to take over your frozen pension plans — and he's betting he can wring enough money out of the hundreds of millions of dollars now sitting in frozen plans in the U.S. to pay off the existing liabilities and turn a tidy profit for his new company and other investors.

"We're very comfortable with our ability to manage the assets against the liabilities in a way that will allow us to earn a consistent return above the liabilities, but without taking inordinate risk in doing so," said Mr. Belt, now chairman of Palisades Capital Advisors LLC, in an interview in the firm's Washington office.

There's no precedent for pension plan liability buyouts in the U.S. So over the past several months, Mr. Belt has been meeting with federal regulators, pension plan sponsors and representatives of investment firms to encourage support for a concept that he argues could serve the best interests of plan sponsors, plan participants and the PBGC alike.

Palisades, which opened in March, is affiliated with Reservoir Capital Group LLC, New York, a private investment firm with $3 billion in assets under management. In addition to Mr. Belt, other Palisades board members are Craig A. Huff, Reservoir president, and Matthew T. Popell, a Reservoir principal. John L. Spencer, a former PBGC staffer, is Palisades' managing director, and Dawn M. Bizzell, another former PBGC staffer, is Palisades' director of operations.

Palisades is not alone. Officials at Citigroup, New York, have also announced interest in pension plan liability buyouts and has a number of U.S. deals in the pipeline, said Ari Jacobs, managing director and head of Citigroup's retirement benefits advisory group.

Citigroup Global Markets Ltd., a London-based investment bank, also recently announced a deal that would make it the first investment bank to take on the liabilities of a pension plan in the United Kingdom, where a variety of pension plan transfers have already been done. Citigroup is taking over the operation of the £218 million ($439 million) Thomson Regional Newspapers Pension Fund, London (Pensions & Investments, Sept. 17).

"Plan sponsors (in the U.S.) are actively looking for new solutions to help them manage and limit their pension exposure," Mr. Jacobs said.

No legal impediment

According to Mr. Belt's analysis, there's no legal or regulatory impediment to the deals in the U.S. But Mr. Belt said he believed federal agencies — including PBGC and the Department of Labor — can and should play a role in ensuring that any transactions in the U.S. serve the best interests of plan participants.

Agency officials appear open to the idea, but have yet to sign off on the concept.

"Shifting an underfunded pension plan from a sponsor with a poor credit rating to a strong financial institution could offer greater security for pension beneficiaries and for the PBGC, but numerous regulatory issues and potential risks remain to be sorted out," said Charles E.F. Millard, PBGC interim director.

Mr. Belt said plan liability transfers would be a "win, win, win" when they shift responsibility for a frozen plan from a credit-challenged sponsor who has no financial expertise to a creditworthy entity with investment experience.

Plan sponsors win, Mr. Belt said, because they get a "wasting trust" liability off their books; plan participants win because their promised benefits receive a higher level of protection, and the PBGC wins because the transfer reduces the risk of default for the frozen plan.

"For participants, this is the continuation of their current plan that will now be backed by a highly creditworthy sponsor," Citigroup's Mr. Jacobs concurred.

Although Mr. Belt said he believes pension liability transfer transactions need no prior approval from the government, he also said there were enough questions about the issue that many parties with an interest in the transactions would prefer to receive "some type of formal or informal blessing from the regulators" before proceeding with a deal.

Mr. MCDERMOTT. Ms. Schwartz.

Ms. SCHWARTZ. Thank you, Mr. Chairman. Just a couple of questions about how we are going to get to the kind of information both the plan sponsors and the participants really need. In hearing your conversation, one of the things that we have not discussed very much today is the fact that—well, one of the reasons we are here is we want to encourage the use of 401(k), we want it to be reasonable for plan sponsors, we want to encourage employers to do it, we want that information available for participants even not a terribly sophisticated workforce. Mr. Minsky suggested that a sophisticated workforce can handle some information, and a less sophisticated workforce cannot. I will get to that in a moment, I think that is of some concern because at least we are concerned about and interested in having workers be able to save, regardless of how sophisticated they are, and that is really one of the reasons we are talking here.

The other is there is a significant cost to the government for 401(k) plans. I think we do not talk about that very much. The tax subsidies for 401(k) plans are estimated at almost $4 billion for

2007 over the next 5 years. We are talking about $233 billion in taxpayer subsidies for 401(k) plans, so there is a reason in addition to the interest we might have in helping Americans to save. There is a substantial public dollar in this, and so if all taxpayers are contributing, we want to make sure that all workers or many workers have access to this.

My question has to do with the competitiveness of the marketplace here and how well it is working in not only reducing fees, but also in providing a wide variety of different options for both employers and employees. So, my question, and I actually may be able to start with Mr. Thomasson, others may want to weigh in on this, do you believe that—who is benefiting in the marketplace? When an employer starts to go off and look for plan service providers, are there a lot of them out there that are available to them? Are they all as qualified? Will they be able to provide the kind of information they need? Will a small businessowner in particular, I think a larger employer has more options, in taking the time to do this but for small business in particular, how much time and effort goes into a small businessperson finding the right service provider and making that they actually get the information they need for them for themselves as the plan provider, but also for their employees?

Mr. THOMASSON. Well, to answer your first question regarding competition and numbers of providers that are out there, there are literally thousands of providers that are out there, and they range from shops that provide administrative or consulting services only with one to two people all the way to the very large bundled providers and large unbundled providers or operations providers. Technology, services, product development, the marketplace itself, participant in-plan sponsor, direction have all added to the competitive nature of the entire environment.

Ms. SCHWARTZ. Do you think this competition has brought more qualified——

Mr. THOMASSON. It happens everyday. There is so much pressure on provider fees today that pricing to value is probably upside down in many cases for many providers. It is under extreme pressure because of a lot of different reasons.

Ms. SCHWARTZ. When an employer—they actually tend to get several different bids and then look at that and how do they actually make, how much time can they afford to spend sort of to actually do the due diligence obviously they have, a fiduciary responsibility to do this once they are involved but maybe, Ms. Klausner, it looks like you are anxious to respond to this?

Ms. KLAUSNER. Yes, thank you. I wanted to actually make sure the record reflects that although the small providers might have more difficulty having leverage and there are a large number of service providers available for the plan sponsors of small businesses, we find that for Honeywell and other members of the Council, there are large providers, large plan sponsors, it is actually a smaller market of service providers available, and we do go out there and ask for all the information that is necessary to look for a competitive bid, but we are not only of course looking for the lowest fee available, we are recognizing that with a very varied workforce and the very complex plans we have, that in order to bring value, the cost may be higher than otherwise expected and may be higher per head per person than even a small plan, so that each plan, large or small, has its unique challenges to finding good service and good value.

Ms. SCHWARTZ. Well, let me just follow up since my time is running out here. You have talked about uniformity, but really one of the issues here of course is not only for the plan to get the right value, but then—maybe I will ask Mr. Minsky this, you sort of seemed to be more hesitant about how much an individual participant might be able to make the judgment and that is exactly why we are asking about what kind—and talking about what kind of information has been provided to participants. We don't give them information they can use that is readable, that is understandable, and in a form that they can make decisions. Are you really suggesting that some of the workforce is just not going to be able to make these kinds of decisions that the employer does and that is good enough?

Mr. MINSKY. Not exactly, but I agree with the point you are making, which is that we have to provide disclosure that is helpful to participants in making the decisions that ultimately they need to make, which are principally whether or not to participate in the plan and then if they choose to participate in the plan, how to invest.

Now, I think the point I was trying to make about sophistication of the workforce is that a plan sponsor, acting as a fiduciary should, and in my experience does, look like the dynamics of its workforce in determining what products make sense in a plan so that, for example, a workforce that is maybe more likely not to take action, that plan sponsor may see that and say that they want to create a default in their plan that leads to success for those participants, so that may lead them to automatically enroll the participants, and if the participants do not elect an investment to default them into an age appropriate life cycle fund, for example, or a managed account, and that is an appropriate decision for a fiduciary to make, which may add cost, but still leads to better results.

Ms. SCHWARTZ. I think our time is up but you raise some interesting points, but I think really one of the things that many of us understand is that as difficult it is to understand some of the information that employees are going to get, we are all going to have to learn a lot more about this and be able to provide information, those who understand it better, in a way that can work.

Mr. MCDERMOTT. Mr. McCrery will inquire.

Ms. SCHWARTZ. Thank you.

Mr. MCCRERY. Thank you, Mr. Chairman. Ms. Klausner, according to the information on our list of witnesses, you are the assistant general counsel for benefits for Honeywell, is that right?

Ms. KLAUSNER. That is correct.

Mr. MCCRERY. So, your job, you are a lawyer?

Ms. KLAUSNER. That is also correct.

Mr. MCCRERY. Your job, among probably others, is to oversee the benefits that Honeywell gives to its employees, is that right?

Ms. KLAUSNER. That is correct, that is one of my jobs and, just for the record, one of my other jobs is to be a member of our Savings Investment Committee, so it is a very specifically named fiduciary role as well, and I just wanted to make sure you knew that.

Mr. MCCRERY. Yes, thank you. So, I think you are an excellent witness to have before us today because that is what you do day in and day out is try to fulfill that fiduciary responsibility on behalf of the corporation or the employer or the sponsor of the plan. Do you think that plan sponsors are, under the current laws and regulations, able to meet your fiduciary obligations?

Ms. KLAUSNER. I think that under today's law, we are able to meet our fiduciary obligations and that is as a basis—as a product of training. On a regular basis, individuals do need to be trained to understand how to fulfill their fiduciary role. In the purchasing of vendor services for a 401(k) plan, they need to understand that although typically they might think of it as a business purchase, the same as business purchases or pencils or paper, that in fact that might be a starting point for the discussion, for the selection of a vendor service, but it goes much further and needs to be looked at from a fiduciary eye. So, with the training and with the understanding of the balance, that we are standing in the shoes of participants of making these choices, I do believe we can fulfill our function.

Mr. MCCRERY. Including with respect to keeping plan fees reasonable?

Ms. KLAUSNER. Yes, I do. In terms of keeping plan fees reasonable, of course "reasonableness" is also based upon its relative comparison to the value being provided. So, we respect the idea that a service provider could offer something which has a higher dollar value, but can allow us to do our job better in terms of providing the retirement savings for individuals. So, by way of example, we have a recordkeeper who today we have been partnering with for some time, and we have placed tremendous value on their ability to very quickly address acquisitions, divestitures, changes in statutory language, change in regulation. We rely upon them very heavily to be able to in a very sophisticated and timely manner, get the information to us so we can get it to our plan participants.

Mr. MCCRERY. How often do you review what fees are being charged to your plan?

Ms. KLAUSNER. On the recordkeeping and on the administration side, fees are reviewed regularly, I would say probably annually. However, there are intermittent conversations because as the services change and as our needs change, and we have to add them and therefore add a fee, we look at the picture as a whole. On the investment side, we meet no less frequently than quarterly. However, given today's investment market and the financial market, I think we have met probably more than once a week to determine the impact of changes by investment managers and in the marketplace and how those may or may not impact our choices that we offer to our participants in the 401(k).

Mr. MCCRERY. I assume you also have occasion to interact with regulatory agencies with respect to these plans, is that right?

Ms. KLAUSNER. That is correct.

Mr. MCCRERY. Do you think the appropriate government agencies are giving adequate attention to plan fee disclosure?

Ms. KLAUSNER. I am very pleased, Honeywell is pleased, the American Benefits Council and its members are very pleased to see that there is this attention by both the Department of Labor, to a smaller degree, but necessary degree, the SEC, and of course many Members of Congress. Again, as I said a couple of times in the testimony and in the prepared written testimony, we do want to continue to see the cooperation among all the different sectors.

Mr. MCCRERY. Thank you very much. Mr. Stevens, quickly, do investors within a 401(k) plan pay more or less in investment fees generally than investors in the retail market?

Mr. STEVENS. The research that we have done, Congressman, suggests that in the 401(k) market, they pay lower fees than they do in the retail market for mutual funds. I should say that there is a lot of information about mutual funds. I cannot necessarily make the same comparison between other investment options in a 401(k) plan and the retail market, but our numbers are very clear. They get a lower price.

Mr. MCCRERY. What is the trend with respect to cost for 401(k) investments?

Mr. STEVENS. I think, again looking at the mutual fund component, it has been downward as investors move to lower-priced funds.

Mr. MCCRERY. Is that due to competition, more competition?

Mr. STEVENS. Enormous competition has driven that, and I think a high degree of transparency around how much the mutual fund costs. That has been something that has been a subject to detailed SEC disclosure for our industry for a very long time.

Mr. MCCRERY. One last question, Mr. Chairman, there is a bill in Congress pending that would mandate that all 401(k) plans provide at least one index fund among the choices available to employees; what is your opinion on Congress mandating that?

Mr. STEVENS. Well, index funds are terrific investments. Our industry really brought them to the fore and helped to popularize them, and they are certainly available in many, many plans as a result of the process that witnesses here have just described of employees selecting investment options. But I think it would be a dangerous precedent, Congressman, that legislation would begin to select investment options in 401(k) plans.

In particular, I would say that there is no single index that is the perfect solution for every investor's need over his or her investing lifetime. It has got to be mixed with other assets, other types of funds, and that is really what has given rise to the life cycle or lifestyle fund that tracks an investor over time and where the investments change, because there is no one index fund solution to the investor's needs.

Mr. MCCRERY. Thank you.

Mr. MCDERMOTT. I want to thank the panel for your informative testimony, and we will perhaps talk to some of you again. Thank you very much.

Our third panel has been waiting for a while. Unfortunately, we are going to have a couple of votes here shortly, but we will try and begin the panel and begin the process. Bertram Scott, who is the Executive Vice-President for Strategy, Integration and Policy for TIAA–CREF, which is an educational fund; Mindy Harris, who is President of the National Association of Government Defined Contribution Administrators; David Wray, who is the President of the Profit Sharing/401(k) Council of America; Lisa Tavares, who is a

Partner of the Venable Law Firm here in D.C.; Norman Stein, who is a Professor from the University of Alabama School of Law, on behalf of the Pension Rights Center; and David Certner, who is Legislative Counsel and Legislative Policy Director for AARP.

Your testimony will be entered fully in the record, and we would like you to stick to the 5 minutes. Although we do not sometimes stick to 5 minutes, we would like you to.

Mr. Scott?

STATEMENT OF BERTRAM L. SCOTT, EXECUTIVE VICE PRESIDENT, STRATEGY, INTEGRATION AND POLICY, TIAA–CREF, NEW YORK, NEW YORK

Mr. SCOTT. Chairman McDermott, Ranking Member McCrery, and Members of the Committee, I am Bert Scott, Executive Vice-President of TIAA–CREF, and I am very happy to be invited here to speak with you today.

I want to start my testimony by telling you a little story if I can that I think is indicative of the 403(b) marketplace. I want to tell you about one of our customers, who worked for 30 years as a maintenance employee in the physical plant of a Big 10 university in the Midwest, someone you might not expect to have a large retirement savings, but because he participated in TIAA–CREF's retirement plan where his contributions were matched by his employer, he ended up retiring as a millionaire. He enjoyed the power of compounding. Unfortunately, there are many people today who are not able to realize the same level of comfort, partially because of barriers that relate to increasing cost-of-living pressures faced by retirees and barriers facing plan sponsors. That is why TIAA–CREF is glad to be here today because it is important to eliminate barriers to saving for retirement.

At TIAA–CREF, we believe in creating an income stream that will support everyone as long as they live. We are a market leader in 403(b) plans, a primary conduit for providing employer-based retirement for employees of not-for-profit institutions. We specialize in annuities, a key vehicle to achieving retirement security. We also hope this Committee will consider addressing issues surrounding limits on contributions, the impact of taxes, whether it makes sense to have incentives and enhancements that benefit both employers and employees. We believe there are public policy benefits to making it easier for employers to encourage savings and employees to save more.

We were instrumental in working with Congress and the IRS in developing the original 403(b) plans or regulations. We pay out more than $10 billion annually in retirement income to over one half million people. Based on this expertise, let me explain how the 403(b) plans work and their distinction. The 403(b) plans were created as a primary means of providing employer-based retirement income to employees of not-for-profit institutions with a defined contribution pension plan design to pay lifetime income. The 403(b) plans are historically simpler to administer, which has led to wider adoption of employer-sponsored plans.

The 403(b) market was not conceived as a supplemental savings or profit sharing program. Plan sponsors typically provide diverse investment options for employees in a 403(b) plan via multiple full-service providers. A typical 403(b) plan may have three or four full-service pension providers at the institutions, and they all compete for individual plan participants offering choice.

In the 403(b) space, individuals typically save two to three times the industry average. We believe that is because our clients understand that this is a retirement plan, not just a short-term savings vehicle. Plan providers must offer a full complement of high-quality investment products, covering various asset classes to help their employees reach their retirement objectives. Investment choices include cash equivalence, equities, fixed income, guaranteed returns, and investment styles such as active and passively managed funds, index funds.

Diverse investment options such as these allow participants within a plan to design a portfolio which best meets their investment goals, risk tolerance and time horizon. A unique feature of the 403(b) market is not only helping employers and employees build savings, but also a robust suite of pay-out options when they retire unlike the 401(k) market, which has historically been focused only on the accumulation phase.

For a defined contribution plan to be successful, employees need advice about savings for retirement, asset allocation, managing risk and return. TIAA–CREF has a long history of providing education and guidance to plan participants to help them evaluate investment alternatives before they make decisions so that they know what they are getting. This year our non-commission consultants will hold more than 110,000 one-on-one counseling sessions with clients throughout the group, some will be your constituents.

One of the most important variables considered by plan sponsors is the cost of expense of providing a 403(b) retirement plan. The range of costs in the market can vary significantly from vendor to vendor. At TIAA–CREF, we provide meaningful disclosure that helps people make informed decisions about that selection. We disclose all fees associated with investing in our registered investment products, in our annual prospectuses for the CREF variable annuity, and TIAA–CREF mutual funds. We break the expenses out into the categories of investment advisory expenses, administrative expenses, distribution expenses or 12(b)(1) fees is something you may be more familiar with, mortality and expense risk charges and acquired fund fees and expenses. In that same prospectus, we also provide individual investors with the impact of expenses on a hypothetical investment of $10,000 over a one, three, five and 10 year period. Our fund performance and prices are posted on our Web site.

Once again, I want to commend the Committee for examining the ways to eliminate barriers to help individuals save for retirement and provide for a lifetime income stream. Some of the barriers we see are increasing cost for retiree health, inflation, complexity, tax incentives, coordination with defined contribution rates and a lack of financial literacy. We hope you will consider establishing incentives that eliminate some of these barriers.

We want to make it easier——

Mr. MCDERMOTT. If you could sum up.

Mr. SCOTT. Yes, I am right now. We want to make it easier for individuals to save more for retirement. We want that individual that we talked about at the beginning—everyone to understand the benefit of compounding. Thank you for inviting me, and I look forward to your questions.

[The prepared statement of Mr. Scott follows:]

WRITTEN STATEMENT
FOR THE RECORD

TO THE
UNITED STATES HOUSE OF REPRESENTATIVES
WAYS AND MEANS COMMITTEE

IN THE HEARING ON
APPROPRIATENESS OF RETIREMENT PLAN FEES

TUESDAY, OCTOBER 30, 2007

SUBMITTED ON BEHALF OF
BERTRAM L. SCOTT
EXECUTIVE VICE PRESIDENT, TIAA-CREF

Chairman Rangel, Ranking Member McCrery, Members of the Committee, I am Bert Scott, Executive Vice President for TIAA-CREF. I appreciate the invitation to appear here today to discuss how the 403(b) market place currently functions, as well as how we think it will evolve in the coming years.

TIAA-CREF has focused on the financial security of individual investors since Andrew Carnegie formed the non-profit Teachers Insurance and Annuity Association of America (TIAA) in 1918 as a fully funded retirement system to help colleges attract talented teachers. Our mission is to ensure the financial security of, and strengthen the institutions and individuals we serve by providing financial products that best meet the unique needs of those in the not-for-profit academic, medical, research and cultural fields. In 1952, TIAA created the College Retirement Equities Fund (CREF), a stock-based fund and the world's first variable annuity.

With over $420 billion in assets under management, TIAA-CREF is a leading financial services organization, a major institutional investor, and one of the world's largest private retirement systems with more than 3.2 million individual investors at more than 15,000 institutions. We are an industry leader in the 403(b) market place, with over 50% of the market share by assets. Currently, TIAA pays out more than $10 billion per year in retirement income to half a million of our participants and first began paying out benefits in 1919.

TIAA is one of only three insurance companies in America to hold the highest ratings from all major rating agencies[1]. Our customer reach extends to every state in the nation. Each of our clients rely on us to help them meet their financial needs to and through retirement. We also administer the 529 college savings plans for 10 states, as well as the Independent 529 Program (I-529). Additionally, TIAA-CREF is one of the largest institutional real estate investors in the nation, with a global portfolio of direct and indirect investments in excess of $67 billion.

<u>How Does the 403(b) Market Place Work?</u>

403(b) plans were created as the primary means of providing employer-based retirement income to employees of not-for-profit institutions including higher education, research and cultural institutions. They were designed to be a defined contribution pension plan that accumulates and pays out lifetime retirement income.

The 403(b) market can, generally, be segmented into two types of plans, the employer sponsored, defined contribution, money purchase plans and the employee funded tax-sheltered annuity (TSA). These two types of plans exist at the same institution as complements to one another, or can stand alone as exclusive offerings.

In our core market of higher education, we see these two types of plans paired together providing aggregate retirement benefits for plan participants. TIAA-CREF's experience focuses primarily on the model that is core to our business, the combined money purchase/TSA 403(b) plan.

The 403(b) market is quite different from its 401(k) corporate counterpart, although there are surface similarities. 403(b) plans were originally conceived and continue to be operated as the primary means of providing employer-based retirement income for those in the not-for-profit community. As a result, while it is a defined contribution program rather than a defined benefit program, its goal is to provide lifetime retirement income. The 403(b) market was not designed as a supplemental savings or profit sharing program, which is how the corporate 401(k) market was originally conceived.

The primary savings vehicle used in the 403(b) market are annuities, which are specifically designed to provide lifetime retirement income. Annuities provide guarantees to the individuals who purchase them. Mutual funds, which exist in the 403(b) world but are more prevalent in the 401(k) world, do not provide for lifetime retirement income and are structured very differently from annuities.

Plan sponsors typically provide diverse investment options for employees in a 403(b) plan via multiple full-service plan providers. It is not unusual for a typical 403(b) plan to have three or four full-service pension providers at the institution that compete for individual plan participants to select them. In contrast, a typical 401(k) plan has a single record keeping and service provider with multiple investment managers on the platform.

Recent events, including regulations released by the Internal Revenue Service in July, and proposed regulations from the Department of Labor have the potential to move 403(b) plans toward a 401(k) model, establishing "401(k) type" reporting requirements for 403(b) plans.

TIAA-CREF is a full service provider, with products that encompass investment choice, participant services and education provided at cost to our institutional and individual clients. It is important to note the differentiation between full service and unbundled providers. In the 403(b) market place, full service providers provide investment services, record keeping services, client education services, and income benefits on behalf of plan sponsors at one "all in" price. Full service providers have menus of services that are offered to plans for one price, regardless of whether you use only one or all of the services provided. Full service providers can offer these suites of products and services because they have built out the infrastructure and have achieved economies of scale to allow them to offer the services at an efficient price.

The alternate plan structure that is much more prevalent in the corporate 401(k) world is that of an unbundled provider, where various plan services are coordinated by a centralized record keeper, but farmed out to various "subcontractors." These various subcontractors then provide investment management, educational services, plan compliance services, and other plan support functions. The costs of these services are paid by revenue sharing from companies offering their investments on the platform and/or participant account charges.

Fiduciary Oversight of 403(b) Plans

If a 403(b) plan is subject to the Employee Retirement Income Security Act of 1974 ("ERISA") it will also be subject to ERISA's fiduciary rules. ERISA covered 403(b) plans include private-sector plans sponsored by Code section 501(c)(3) organizations, under which the employer takes an active role making employer plan contributions and/or managing the plan, such as choosing the plan investment options.

Non-ERISA 403(b) plans include private employee elective deferral only 403(b) plans in which the employer does not take an active role (as described in Department of Labor (DOL) Regulation section 2510.3-2(f)), non-electing church plans, and governmental plans. Non-ERISA covered 403(b) plans will not be subject to ERISA fiduciary rules but will be subject to those fiduciary rules existing at common law or applicable state statutes.

State fiduciary requirements for governmental 403(b) plans often mimic ERISA fiduciary requirements and ERISA is often followed as a best practice.

403(b) plans are almost always run as participant directed individual account plans, and many of them choose to comply with ERISA section 404(c). That section provides that plan fiduciaries will not be liable for the participant's exercise of investment control over his or her account. However, as in the case of 401(k) plans, plan fiduciaries will remain liable for the prudent selection and monitoring of plan funding and investment alternatives offered under the terms of the plan. In most instances (church plans being the exception), 403(b) plans may only invest in annuity contracts and mutual funds.

403(b) Vendor Selection Process

Plan sponsors in the 403(b) market place often select vendors through a competitive bid process, initiated through a Request for Proposal (RFP). In our experience, large, mid and small plans have different needs and different options that are readily available in the current market place.

Larger plans that enjoy scale can pick from a greater assortment of investment options and plan services offered by larger providers servicing the 403(b) market. Full service providers service the majority of the higher education market place, with sole record keeping arrangements (the 401(k) model) being utilized or contemplated by a number of the largest institutions in the market.

Small plans, similar to small businesses in the private sector, typically do not have the resources in-house to administer complex plans. Based on their lower participant and asset volume they also cannot generate the scale required to attract some of the larger providers. As a result, small plans usually choose among plans offering standard plan administration and pre-set investment options.

When selecting a vendor(s) to offer the retirement plan services, employers weigh a number of factors in the process including investment options, plan administration, education, investment advice and price.

Investment Options

Plan providers must offer a full complement of high quality investment products covering various asset classes to help their employees reach their retirement objectives.
We believe that successful providers in the 403(b) marketplace must offer a full complement of high quality investment products covering various asset classes including cash equivalents, equities, fixed income, guaranteed returns and investment styles such as actively and passively managed funds. Diverse investments options such as these allow participants within a plan to design a portfolio, usually with the advice from the vendor, which best meets their investment goals, risk tolerance, and time horizon.

In recent years, lifecycle or target retirement date funds have proliferated in defined contribution plans. The simplicity of "one stop shopping" inherent in these types of funds appeals to both plan administrators and individual plan participants who may not feel confident making an investment allocation decision on their own.

Finally, in order to compete, more and more vendors are offering an open architecture investment platform, where investments from other companies can be offered as a complement to the firm's proprietary investment options. When evaluating investment proposals, larger plan sponsors sometimes employ an internal investment committee or third party benefit consultants, who perform due diligence reviews of each of the proposed investment options and suggest alternatives when necessary.

Retirement Income

TIAA-CREF's mission is to help individuals meet their financial and savings needs to and through retirement. We work with plan participants to evaluate if they are saving enough for retirement, that they are invested properly to meet their goals and that they will not outlive their retirement income.

Plan administrators face a critical challenge in helping their employees address these issues as they transition into retirement. It is important that employers act to provide appropriate retirement plans and policies that promote adequate and secure retirement income for employees. Plans should be designed to manage the various risks that threaten retirement income adequacy and security, including investment volatility, longevity and inflation.

Some portion of an individual's retirement accumulation should be guaranteed for a lifetime and a portion should be allocated to address the negative effects of inflation. Secondary purposes such as wealth accumulation, providing survivor income and other death and disability benefits also are appropriate components of a comprehensive retirement benefit policy.

The recent rollouts of new retirement income mutual funds continue a trend of asset management providers and insurance companies looking for ways to tout their company's ability to help provide income for life.

However, unlike the annuity products TIAA-CREF has offered for nearly 90 years, these new funds, while they seek to distribute monthly income, do not come with any guarantees, as to either the amount paid to the retiree or to the duration of those payments. This means investors must evaluate how much money they have accumulated, the pace at which income can be withdrawn, how long they will live, as well as market contingencies.

Plan Services

An important variable in the selection of a plan sponsor is the breadth of assistance a provider delivers in retirement plan administration. Successful vendors offer comprehensive services that include record keeping, enrollment, reporting, client education and advice, as well as payment services.

The most successful vendors offer comprehensive services for plan sponsors which include plan design, implementation of new plan features, enrollment of participants, help in keeping the plan compliant and open exchanges of data with an institution's human resource and payroll area as well as plan fiduciaries. Reports are generated at both the individual and plan level on a regularly scheduled basis (quarterly for individuals), or on an ad hoc basis as needed. Plan services also extend to the participants within the plan.

Examples of these services would include:

- 24-hour access to account balances with the ability to change allocations and make transfers via a secure web connection.
- Access to a registered representative for account information and guidance via a toll free number for extended hours into the evening and weekend.
- Access to individual counseling session at the employees' workplace.
- Group education meetings and webinars on the pertinent financial topics of the day.

Individual Education and Objective Investment Advice

For a 403(b) plan to be successful, the participants in that plan need to be educated about the importance of saving for retirement and investing wisely, along with balancing the appropriate amount of risk and return needed to meet their specific retirement goal. TIAA-CREF has a long history of providing education and guidance to plan participants to help them evaluate investment alternatives before they make decisions.

This year our individual consultants will hold more than 110,000 one-on-one counseling appointments with clients throughout the country. We provide our clients with personalized, objective advice within the framework of a "high-touch" experience delivered by non-commissioned consultants working for a not-for-profit entity. This is critical, as plan participants today are faced with a much broader range of investment options and choices in their retirement plans. This is particularly important for employees as they approach retirement, when so many variables need to be assessed and risks mitigated: investment risk, longevity risk, inflation risk, health risk and unexpected expense risk.

The bundling of these components provides an advice offering unique in the industry. We provide objective, third party advice on all the funds that we record keep on our platform, including not only TIAA-CREF's investment funds but also non-proprietary investment products. The service is available to all participants, and is provided at no additional cost, ensuring that those participants most in need of investment and income management advice can obtain it.

Price

One of the most important variables considered by plan sponsors is the cost and expense of providing a 403(b) retirement plan. The range of cost in the market place can vary significantly from vendor to vendor. At TIAA-CREF we provide meaningful disclosures to help plan participants and their beneficiaries make informed decisions about building their retirement future. As a matter of course, we disclose all of the expenses associated with investing in our registered investment products in our annual prospectuses for the CREF Variable Annuities and TIAA-CREF Mutual Funds. Expenses are broken out into the categories of Investment Advisory Expenses, Administrative Expenses, Distribution Expenses (12b-1), Mortality and Expense Risk Charges and Acquired Fund Fees and Expenses[2].

In the same document, we also provide individual investors with the impact of expenses on a hypothetical investment of $10,000 over a 1, 3, 5, and 10 year period, for each of our investment options. All of our funds' performance and prices are posted on our website.

Opportunities for Congress to Help 403(b) Plan Providers

We commend Congress for acting to make investing in retirement plans easier for all Americans. Related to the challenges of increasing savings, our clients have expressed concern about the escalating cost of providing health care to retirees.

According to a recent TIAA-CREF study, individuals retiring now will need to have saved about $210,000 in order to pay for health care expenses during retirement from age 65 to age 90. This is the amount not covered by Medicare and does not include the potential costs for long-term health care. It is also increasingly difficult for employers in our markets to continue to finance the costs of retiree health coverage. The likely outcome is that employers in the 403(b) market will be reducing these retiree health commitments going forward, and employees and retirees will be left to shoulder an increasing share of these costs.

Saving for healthcare expenses can certainly be accomplished though retirement savings vehicles such as 403(b) and 401(k) plans. However, contribution limits to these plans and the tax treatment of distributions limit their ability to fully meet the savings needs. Further, under accounting standards employer and employee contributions to these plans are not considered as assets when calculating the liabilities for providing retiree healthcare coverage to former employees. Employers offering retiree healthcare coverage and employees saving for retirement expenses will both be better served if incentives and/or enhancements are made to specialized defined contribution savings vehicles.

Plans sponsors and plan providers have a responsibility to help individuals become more aware of healthcare costs and to encourage preparedness. Employees must understand the importance of saving for retirement, including the daunting cost of healthcare, and with clear incentives to utilize specialized savings vehicles, both plan sponsors and plan providers will be in a better position to ensure financial security of retirees.

We are fortunate in the United States that life expectancy has been steadily increasing, but we must face the public policy challenges that come with that. Another proposal we would encourage Congress to consider is to provide tax incentives for individuals who select to annuitize a portion of their retirement contributions. By encouraging individual investors to elect a stream of payments that they cannot outlive, we will have effectively addressed the longevity risks of our seniors outliving their retirement assets.

We would like to thank the Committee for inviting TIAA-CREF to share our views on this important topic. I look forward to answering any questions you may have.

---

[1] A++, A.M. Best Company (as of 6/07); AAA, Fitch (as of 5/07); Aaa, Moody's Investors Service (as of 5/07); AAA, Standard & Poor's (as of 7/07) – the highest possible ratings from these independent analysts. These ratings of TIAA as an insurance company do not apply to the TIAA Real Estate Account, to CREF or to the mutual funds.

[2] Acquired Fund Fees and Expenses are the accounts proportionate amount of the expenses of other investment vehicles in which they invest. These expenses are not paid directly by participants. Instead, participants bare these expenses indirectly because they reduce the performance of the investment vehicle in the Accounts invest.

Mr. MCDERMOTT. Ms. Harris.

STATEMENT OF MINDY L. HARRIS, PRESIDENT, NATIONAL ASSOCIATION OF GOVERNMENT DEFINED CONTRIBUTION ADMINISTRATORS, PORTLAND, OREGON

Ms. HARRIS. Thank you, Mr. McDermott and Mr. McCrery and Members of the Committee for having us here today. On behalf of NAGDCA, I would like to thank you for this opportunity to testify today on this most important issue that touches so many Americans, who may or may not have adequate income for their retirement needs. I also want to extend NAGDCA's appreciation to this Committee and to Congresswoman Schwartz and Congressman Johnson for your Resolution for National Save for Retirement Week, which we celebrated last week. This is very helpful to plan sponsors across the country in helping us promote education and awareness to our participants and our employees, some of whom are prospective participants.

We also applaud Congress and the Federal Government for its increasing interest in fee disclosure and transparency, and we really believe that these efforts will lead to higher levels of understanding by plan sponsors and participants of the fees being charged for the administration and investment of their retirement savings. We look forward to working with you as you review the issue of fees in defined contribution plans. As governmental entities ourselves, we always welcome and open and transparent process when it comes to managing and investing our public employees' retirement savings.

The very nature of local control and open government laws dictates a great deal of oversight in State and local government plans. There is also a significant amount of collaboration between the employees and the employers in developing these plans. Not only do our plans have elected officials who are accountable to the public and to our plans, but we also have rules affecting procurement, requiring most contracts to be reviewed with a prescribed regular frequency.

NAGDCA believes that to achieve retirement security and to assure that millions of public sector employees will be self-supporting during their retirement years, that it is imperative to maintain a shared responsibility between employers and employees to fund retirement income. We believe that this is best accomplished through the combination of defined benefit retirement plans and our voluntary supplemental defined contribution plans. It is in this spirit that NAGDCA advocates for policies that enhance defined contribution plans to encourage public employees to save for retirement and to supplement their defined benefit pensions. The goal of any proposal to alter or significantly change employer-sponsored supplemental retirement savings plans should be to enhance or simplify the current procedures and to assure that the administrative costs to employers and participants are reasonable.

It is in this vein that we recently undertook a survey of our membership regarding how fees are determined and how they are disclosed to employees. We have also surveyed our members regarding their views on the reasonableness of fees and how they evaluate them, and I look forward to sharing our findings with you today. I will provide you with an overview and submit my testimony, including our actual survey in its entirety, for the record.

About our fee disclosure survey, in summing up our survey findings, NAGDCA plan sponsor members indicated that they understand the importance of fees very well. When selecting a service provider for plan administration, fees are evaluated in plan decisions a great deal. Eighty-6 percent of our State government respondents and 55 percent of local and smaller governmental entities reported receiving fee disclosure information through quarterly website updates, participant statements and general communication brochures.

Some additional questions were also raised as a result of our findings. For example, are participants receiving enough fee disclosure and education or are they receiving too much, which may lead to possible confusion? What should the expectations be for plan sponsors to monitor and understand fees and what should participants have to monitor and understand?

It is our position that plan sponsors and plan participants have different levels of need for detailed fee information, and our plan sponsors recognize and work very hard to uphold their fiduciary responsibility by engaging in a higher level of education about fees and related issues in order to make careful, informed decisions on behalf of their participants.

Seventy percent of our survey respondents also indicated that they review their plan's administrative and investment management fees at least annually and, in some cases, multiple times throughout the year. Plan sponsors also indicated that they have a pretty good understanding of assessed fees. One area for possible improvement, however, is the understanding of fees that are not always included in every plan. Perhaps requiring a better explanation of this terminology would help increase the understanding of these types of fees. We found that passively managed index funds are perceived as being a lower cost option by plan participants, and the survey also found that these lower cost index funds are already available in most plans.

Plan fees and plan disclosure is just one piece of the overall equation. Education should takes a holistic approach, providing information about the plan fees, as well as overall investment performance and how the two factors relate to one another.

Over the past few years, with greater plan-sponsored education on fees, all government market segments responding to our survey agreed that fees have generally decreased. The public market is different from the private market in that bids for services and investment products are generally mandated to be reviewed or competitively bid within a normal cycle of time, typically three to five years. There is also a greater degree of public access for review of fees and disclosure of plan-related information, and, finally, there is a greater degree of accountability in the public market as consensus is reached and elected bodies publicly agree to contracts and their terms.

Regarding reasonableness of fees, what plan sponsors acting as fiduciaries consider reasonable can be very subjective. The fiduciary has to consider many variables in determining what he or she believes to be reasonable. In governmental plans, what is considered reasonable is commonly a collective decision by board members after an overall evaluation of many factors, including plan services and investment performance. The public sector has the advantage of open disclosure of fees during the public procurement process, which may have a positive impact on the amounts of fees that are charged in our plan.

NAGDCA, in surveying our membership, found out the majority of plans have benchmarks to evaluate whether their fees are reasonable and have negotiated reasonable fees according to these benchmarks for their participants. In the end, trying to define what reasonable fees are may ultimately be a plan by plan and a local decision.

In summary, I would like to emphasize the ongoing importance of education so that individuals and families will understand what their needs for retirement will be. Again, I would like to thank this Committee and this Congress for passing the Resolution for National Save for Retirement Week, which many of us celebrated last week. Your leadership on this issue has enabled us to plan retirement fairs and events, ensure significant advertising regarding saving for retirement, and has also encouraged the involvement of both the public and the private sectors in educating our participants about this important issue.

We look forward to continuing to work with you as you review all of these issues, and I would be pleased to answer any questions that you may have today. Thank you very much.

[The prepared statement of Ms. Harris follows:]

Statement of Mindy L. Harris, President, National Association of Government Defined Contribution Administrators, Portland, Oregon

Good morning Mr. Chairman and members of the Committee. I am Mindy Harris, President of the National Association of Government Defined Contribution Administrators (NAGDCA). I am also the Chief Financial Officer for Multnomah County, in Portland Oregon.

On behalf of NAGDCA, I thank you for this opportunity to testify today on this most important issue that touches so many Americans who may or may not have adequate income for their retirement needs. We applaud Congress and the Federal Government for its increasing interest in fee disclosure and transparency and believe that these efforts will lead to higher levels of understanding by plan sponsors and participants of the fees being charged for the administration and investment of their retirement savings. We look forward to working with you as you review the issue of fees in defined contribution plans, and as governmental entities ourselves, we always welcome an open and transparent process when it comes to managing and investing our public employee's retirement savings.

The very nature of "local" control and "open government" laws, dictates a great deal of oversight in state and local government plans. There is also a significant amount of collaboration between the employees and the employers in developing the plans. Not only do our plans have elected officials who are accountable to the public and to our plans, but we have rules affecting procurement requiring most contracts to be reviewed with prescribed regular frequency.

Ongoing education of plan sponsors is one of NAGDCA's key missions, and as plan sponsors and administrators, we encourage and engage in counseling and education of participants as a matter of course.

NAGDCA believes that to achieve retirement security—and to assure that millions of public employees will be self-supporting during their retirement years—it is imperative to maintain a shared responsibility between employers and employees to fund retirement income. We believe that this is best accomplished through the combination of defined benefit retirement plans and voluntary supplemental defined contribution plans.

It is in this spirit that NAGDCA advocates for policies that enhance defined contribution plans to encourage public employees to save for retirement and to supplement their defined benefit pensions. State and local governments are proud of the supplemental retirement savings plans that have been created by working jointly with the federal government, the resulting high savings rates in our plans, and the increased retirement preparedness of our employees. The goal of any proposal to alter or significantly change employer sponsored supplemental retirement savings plans should be to enhance or simplify the current procedures, and to assure that the administrative costs to employers and to participants are reasonable.

It is in this vein that we undertook a recent survey of our membership to determine how fees are determined and how they are disclosed to employees. We have also surveyed our members regarding their views on the "reasonableness" of fees and how they evaluate them. Finally, we have asked our members to describe the make-up and structure of their boards, including the ratio of employees to employers (who are typically in the plans themselves) and the roles of labor and other key decision makers.

I look forward to sharing our findings with you today. I will provide you with an overview and submit my testimony, including our actual survey, in its entirety, for the record.

About NAGDCA:

NAGDCA was founded in 1980 and is the leading professional association representing public employer sponsored deferred compensation and defined contribution plan administrators. NAGDCA represents administrators from all 50 states and over 150 local governmental entities, as well as private industry plan providers. These states have, under their auspices, over 5,000 local government deferred compensation plans. NAGDCA also represents nearly 100 industrial members that provide services to public plan sponsors.

NAGDCA is an organization in which its members work together to improve state and local government defined contribution plans including § 457(b), § 401(k), § 401(a), and § 403(b) plans through a sharing of information on investments, marketing, administration and laws relating to public sector defined contribution plans.

Our members administer state and local government plans that are regulated under section 457 of the Internal Revenue Code (IRC). These plans, which supplement state and local defined benefit programs, provide a convenient vehicle for public employees across the country to save for retirement. In all cases, full time employees of the entity offering the plan are eligible to participate (and, in many cases, part time employees are also eligible to participate). Altogether state and local defined contribution plans administer approximately three trillion dollars in assets across the country.

About NAGDCA's Fee Disclosure Survey:

The following results document the information gathered from our member survey conducted in August 2007 regarding fee disclosure in defined contribution plans.

In summing up our findings, our survey shows that NAGDCA plan sponsor members understand the importance of fees, relative to the plan participants they represent. When selecting a service provider for plan administration, fees are evaluated in plan decisions "a great deal" (which was the answer by approximately 70% of all survey respondents).

- When plan sponsors were asked how well their participants understood fees, the majority response was "somewhat" across all market segments (as opposed to "understands very well," "understands very little" or "not at all"). This is despite the wide array of education/communication vehicles currently being utilized to disclose fees on a quarterly basis.
- 86% of state government respondents and 55% of local and smaller governmental entities (55%) reported receiving fee disclosure information through quarterly web-site updates, participant statements, general communication brochures, and/or phone system updates.In addition, government members gave the industry an overall rating of 4 (with 5 being the highest) for providing education to plan sponsors on fees. Some additional questions were raised as a result of these findings. For example, are participants receiving enough fee disclosure/education, or are they receiving too much, which may lead to possible confusion? And, what should the expectations be for plan sponsors to monitor and understand fees, and what should plan participants monitor and understand? It is our position that plan sponsors and plan participants have different levels of need for detailed fee information, and our plan sponsors recognize and uphold their fiduciary responsibility by engaging in a higher level of education about fees and related issues in order to make careful and informed decisions for the benefit of their participants.
- 70% of our respondents indicated that they review their plans' administrative fees and investment management fees (also known as expense ratios) at least

annually and in some cases multiple times throughout the year. Larger entities indicated that they reviewed their fees more frequently than smaller entities.

- Most governmental entities, approximately 70%, use an independent consultant to assist with the disclosure and understanding of fees. It is interesting to note that our survey revealed that smaller plans actually use Consultants more frequently than larger state plans. This is likely due to the availability of additional resources in larger governmental entities.
- Plan sponsors indicated that they have a good understanding of assessed fees. One area for possible improvement, however, is the understanding of fees that are not always included in every plan (i.e., Mortality and Expense risk fees, Sub-transfer agency fees, and Finders fees). Perhaps a better explanation of this terminology would increase the understanding of these types of fees.
- The opinion of our survey task force, based on our survey results, is that passively managed index funds are perceived as being a lower cost option by plan participants. The survey found that these lower cost index funds are already available. Of those entities responding to the survey, 100% of state entities and 93% of local government entities indicated that they currently offer a passively managed index fund. This raises additional concerns. Is a lower cost option or a higher cost option (with better performance) the optimum retirement solution for plan participants? Plan fees and fee disclosure is just one piece of the overall equation. Education should take a holistic approach, providing information about plan fees, overall investment performance, and how the two factors relate to one another.
- Conflicts of interest with regard to provider relationships were also explored in our survey as well as plan sponsor understanding of revenue sharing arrangements. Over 70% of plan sponsors responding to our survey stated that specific information about revenue sharing arrangements is provided at least annually, with more than 40% of these employers receiving a report on the total revenues that result from reimbursements and fees. With regard to other types of relationships, however, there appears to be less of an understanding of these arrangements; approximately 50% of plan sponsors require disclosure only when renewing contracts or bidding for a new contract/vendor.
- Most plan sponsor respondents, across all market segments, indicated they were concerned with roll-overs out of government sponsored plans and into higher priced option sat the recommendation of outside financial advisers who were not affiliated with existing plans. The majority of all Government entities responded that they are "very" or "somewhat" concerned about this.
- Over the past several years, with greater plan sponsor education on fees, all government market segments agreed that fees have generally decreased(assuming similar assets and services). The public market is different from the private market, in that bids for services and investment products are generally mandated to be reviewed or competitively bid within a normal cycle of time (typically every three to five years). There is also a greater degree of public access for review of fees and disclosure of plan related information. Finally, there is a greater degree of accountability in the public market as consensus is reached and elected bodies publicly agree to contracts and their terms.

While some issues regarding fee disclosure were identified as being in need of improvement or further discussion, there were also positive findings from the survey that showed most defined contribution plan sponsors are aware of and understand plan costs. The survey also showed that industry partners are informing participants about fees associated with their account in a variety of formats including periodic account statements and customized plan Web-sites and newsletters.

Regarding "Reasonableness" of Fees:

What plans sponsors, acting as fiduciaries, consider "reasonable" is very subjective. The fiduciary has to consider many variables in determining what he/she believes is reasonable. Some of the factors may include federal, state, and local laws. Labor contracts and plan design may also impact what the fiduciary considers "reasonable." These are just a few of the factors. In governmental plans, what is considered "reasonable" is commonly a collective decision by the board members after an overall evaluation of many factors, including plan services and investment performance. Often, when making the decision, fiduciaries listen to the advice of consultants that have been hired because of their expertise and knowledge of the industry standards then prevailing. The public sector has the advantage of open disclosure of fees during the public procurement process, which may have a positive impact on the amounts of fees that are charged in our plans.

Additionally, there is a "Prudent Man" standard. This is the standard under which the fiduciary must act. The fiduciary is required to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use, in the conduct of an enterprise of a like character and with like aims."

NAGDCA, in surveying our membership found the following from direct questions regarding "reasonableness" of fees:

- Sixty-six percent of total respondents have a standard they rely on to determine whether fees are reasonable.
- Seventy-six percent of total respondents have compared the fees in their plan against fees charged to individual investors for similar investment products.
- Seventy-eight percent of total respondents rated their administrative fees at least a 4 out of 5 with 5 being "very reasonable".
- Sixty-eight percent of total respondents rated their investment fees at least a 4 out of 5 with 5 being "very reasonable".

Regarding Board Structure:

NAGDCA, through surveying our membership, has found the following thirty-five percent response rate

- Respondents have an average of 8 members on their defined contribution (DC) Board of Directors. Very few respondents have indicated that they do not have a Board of Directors.
- For those with a Board of Directors, we found the following results.
  - Thirty-five percent of respondents require Board members to be participants in their plan.
  - Forty-one percent have at least 50% of their Board members who are considered employee representatives.
  - Sixty-four percent of respondents have Board members that are not employees. Those board members represent retirees, taxpayers, elected officials, and financial planners.
  - Seventy-one percent indicated their board members are appointed by the Governor, Executive Director, or by plan participants. Twenty-two percent indicated their board members are both appointed and elected. Seven percent indicated are all elected.

In the end, trying to define what "reasonable" fees are may ultimately be a plan by plan and a "local" decision.

In summary, I would like to emphasize the ongoing importance of education so that individuals and families understand what their needs for retirement will be. That is why NAGDCA is so pleased that this Committee and this Congress passed a resolution calling for a National Save for Retirement Week, which many NAGDCA plan sponsors celebrated just last week. Your leadership on this issue has enabled us to plan retirement fairs and events, to ensure significant advertising regarding saving for retirement, and has encouraged the involvement of both the public and private sectors in educating our participants about this important issue.

NAGDCA looks forward to continuing to work with you as you review all of these issues, and I would be pleased to answer any questions you may have today.

Thank you.

Mr. MCDERMOTT. The Committee will stand in recess for two votes. We will be back somewhere around two o'clock. Thank you.

[Recess.]

Mr. MCDERMOTT. Mr. Wray?

STATEMENT OF DAVID L. WRAY, PRESIDENT, PROFIT SHARING/401(k) COUNCIL OF AMERICA, CHICAGO, ILLINOIS

Mr. WRAY. Chairman McDermott, Ranking Member McCrery and Members of the Committee, I appreciate the opportunity to appear today and discuss retirement plan fees and expenses. The employer defined contribution system is a great success story. The automatic enrollment provisions and the pension permanency provisions included in the Pension Protection Act of 2006 have positioned the DC system to move to a new level, a level that will help expand the system and reach out to major groups that lack other workers in the system, low-income workers and small employers. The amount of money in the system is expanding rapidly, and that is why paying attention to these fee disclosures is so important. We strongly support improving disclosure at all levels.

As you have heard today, the Department of Labor is undertaking 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 this is the best approach to enhance fee transparency in a measured and balanced manner. We urge Congress to delay taking legislative action until the DOL has completed its work. Legislation at this time would re-start the regulatory process and significantly delay the implementation of the changes that we all seek in disclosure for participants and fiduciaries.

To comply with ERISA, plan administrators must ensure that the aggregate price of the services in a bundled arrangement is reasonable at the time the plan contracts or the services and 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 cost, such as plan administration and participant recordkeeping. The plan administrator should be fully informed of all the services included in bundled arrangements to make that assessment.

Many plan administrators, especially small companies, however, prefer reviewing costs in an aggregate manner. 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. For example, if a person buys a car, they do not need to know the price of the engine if it were sold separately. They do need to know the horsepower and warranty. Small businesses in particular prefer the simplicity in many cases of the bundled fee arrangement. Congress should consider the need to increase plan sponsorship by small companies if it considers legislating changes to bundled fee disclosure arrangements.

The defined contribution plan system is very successful. As an example, I refer to Martin Tractor Company, a small company in Topeka, Kansas, that fixes farm equipment. In 2006, they had five non-management workers retire from their plant. These people had worked their entire career at this company. The average pay for these people was $45,000 and the average lump sum was $485,000. These people had almost 11 times final pay to supplement—to use to supplement their Social Security wages. These people are going to have higher levels of income in retirement when they were working. The defined contribution plan system has incredible potential for American workers. We very much appreciate the fact that the legislative process is paying attention to the system because it is going to be so important to America's workers. At the same time, we prefer to work through the regulatory process when we are actually implementing the changes that are needed. Certainly, if the Department of Labor does not come out with appropriate direction, we would envision that the legislative process would immediately take hold and kick in.

Thank you very much. I would be delighted to answer any questions that you have.

[The prepared statement of Mr. Wray follows:]

Statement of David L. Wray, President, Profit Sharing/401(k) Council of America, Chicago, Illinois

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.

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 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 manor.

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.

We strongly support concise, effective, and efficient fee disclosure to participants. We also support increased fee transparency between service providers and plan sponsors. We commend Chairman Rangel for conducting this hearing to gain further insight into the employer-provided defined contribution retirement plan system and the critical role that plan fees play in retirement asset accumulation.

DEFINED CONTRIBUTION PLANS WORK FOR EMPLOYEES, EMPLOYERS, AND AMERICA

Employers offer either a defined benefit or defined contribution, and sometimes both types, of retirement plan to their workers, depending on their own business needs. According to the Investment Company Institute, Americans held $16.6 trillion in retirement assets as of March 30, 2007.[1] This is nearly 17% of the $97.9 trillion in investible assets worldwide.[2] Government plans held $4.2 trillion. Private sector defined benefit plans held $2.3 trillion. Defined contribution plans held $4.2 trillion in employment based defined contribution plans and $4.4 trillion in IRAs. Employer-based savings are the source of half of IRA assets. Ninety-five percent of new IRA contributions are rollovers, overwhelmingly from employer plans.

There are questions about the ability of the defined contribution system to produce adequate savings as it becomes the dominant form of employer provided retirement plan. Some claim America is facing a retirement savings crisis. To answer this question, a baseline for comparison is required. The Congressional Research Service reports that in 2006, 23.6% of individuals age 65 and older received any income from a private sector retirement plan. The median annual income from this

[1] *The U.S. Retirement Market, First Quarter 2007,* Investment Company Institute, October 2007.

[2] *Tapping Human Assets to Sustain Growth: Global Wealth 2007*, Victor Aerni, Christian de Juniac, Bruce M. Holley, Tjun Tang, October 12, 2007.

source was $7,200.[3] This income stream represents a lump-sum value of $90,000, assuming the purchase of a single-life annuity at an 8% discount rate. Individuals age 65–69 had higher median annual income from a private sector retirement plan, $9,600 ($120,000 lump sum value), but only 19.9% of those age 65 or older received any income from this source. Overall, however, the elderly are not impoverished. In 2006, 9.4% of Americans 65 and older had family incomes below the federal poverty rate, the lowest rate for any population group. How will the next generation of retirees fare compared to current retirees?

We hear about a negative savings rate in America, with some noting that Americans are saving less now than during the Great Depression. Intuitively, something must be wrong with this statistic as the total amount set aside for retirement has almost tripled in 12 years.[4] A 2005 analysis by the Center for Retirement Research sheds considerable light on the matter. They discovered that the NIPA (National Income and Products Account) personal savings rate for the working-age population was significantly higher than the overall rate, which was then 1.8%. Working-age Americans were saving 4.4% of income, consisting almost exclusively of savings in employment-based plans. This does not include business savings, which, of course, are owned by individuals. Those 65 and older were "dissaving" at negative 12% because they were spending their retirement assets, which are not considered income. The report accurately predicted that, as baby-boomers begin to retire, they will consume more than their income and the savings rate as currently defined would go even lower.[5]

The Congressional Research Service reports that married households in which the head or spouse was employed and the head was age 45–54 held median retirement account assets of $103,200 in 2004. Similar unmarried households held $32,000. An identical married household headed by an individual age 55 and older held median retirement account assets of $119,500 in 2004.[6]

While some workers have enjoyed a full working career under a defined contribution plan such a as profit sharing plan, 401(k)-type plans in which the employee decides how much to save have existed for only slightly over twenty years, and most participants have participated in them for a much shorter period of time. The typical participant in 2000 had only participated in the plan for a little over seven years.[7] Policymakers must be wary of statistics citing average 401(k) balances and balances of those approaching retirement because they have not saved over their full working career and some balances belong to brand new participants. For example, a recent Investment Company Institute report stated that at the end of 2006, the average 401(k) balance was $61,346 and the median balance was $18,986.[8] The median age of the participants in the study was 44 and the median tenure in their current 401(k) plan was eight years. But when the study looked at individuals who were active participants in a 401(k) plan from 1999 to 2006 (including one of the worst bear markets since the Depression) the average 401(k) balance at the end of 2006 was $121,202 and the median balance was $66,650. Long-tenured (30 years with the same employer) individuals in their sixties who participated in a 401(k) plan during the 1999–2006 period had an average account balance of $193,701 at the end of 2006. The study does not reflect that many individuals and households have multiple 401(k)-type accounts or assets rolled over into an IRA.

The lesson is clear—long term participation in a 401(k) plan will result in the accumulation of assets adequate to provide a secure retirement. The Congressional Research Service estimates that a married household that contributes ten percent of earnings to a retirement plan for 30 years will be able to replace fifty-three percent of pre-retirement income. If they save for forty years, they will replace ninety-two percent of income.[9] A ten percent savings rate is realistic given average contribution

---

[3] *Income and Poverty Among Older Americans in 2006*, Congressional Research Service, September 24, 2007.

[4] *The U.S. Retirement Market, First Quarter 2007,* Investment Company Institute, October 2007.

[5] *How Much are Workers Saving?,* Alicia Munnell, Francesca Golub-Sass, and Andrew Varani, Center for Retirement Research at Boston College, October 2005.

[6] *Retirement Savings: How Much Will Workers Have When They Retire?*, CRS Report For Congress, January 29, 2007.

[7] *Rise of 401(k) Plans, Lifetime Earnings and Wealth at Retirement*, James Poterba, Steven F. Venti, and David A. Wise, NBER Working Paper 13091, May 2007.

[8] *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, Investment Company Institute, August, 2007.

[9] *Retirement Savings: How Much Will Workers Have When They Retire?*, CRS Report For Congress, January 29, 2007.

rates of seven percent and average employer contributions of three percent. These estimates do not consider Social Security payments

These statistics mean little if a worker is not saving for retirement. And one fact is abundantly clear—whether or not a worker saves for retirement is overwhelmingly determined by whether or not a worker is offered a retirement plan at work. In March of 2007, sixty-one percent of private sector workers had access to a retirement plan at work and fifty-one percent participated. Seventy percent of full-time workers had access and sixty percent participated. Seventy-eight percent of workers in establishments employing 100 or more workers had access and sixty-six percent participated. Only forty-five percent of workers in establishments of less than 100 workers had access to a plan and thirty-seven percent participated. Three-quarters of workers earning at least fifteen dollars per hour had access and sixty-nine percent participated. Only forty-seven percent of workers making less than fifteen dollars per hour had access and only thirty-six percent participated. Seventy-seven percent of all workers chose to participate when offered a defined contribution plan at work, with seventy percent of those making less than fifteen dollars per hour opting to participate.[10] Policymakers should consider that these participation rates are at a single point in time. They are not indicative of whether or not a individual or household will choose to participate in a 401(k) plan for a substantial period of a working career.

Opportunities for improvement

What do all these data tell us? First, the employer provided defined contribution system has demonstrated that it can provide asset accumulation adequate for a secure retirement for workers at all income levels as long as individuals participate. The participation rate when offered a plan is encouraging, but can be improved. There are two areas in which to concentrate our efforts on improvement; lower-paid workers and small business plan coverage. We also need to increase participation by African-Americans and some ethnic groups, as revealed by some very recent studies. Small business owners need simplicity and meaningful benefits for themselves to compensate for the costs of providing a plan to their workers. Congress should keep this in mind as they examine plan fees.

We believe that making the 2001 EGTRRA pension provisions permanent in the Pension Protection Act of 2006 will help convince small business owners to offer a plan. Permanency removed a cloud of uncertainty that likely would have frozen small business plan growth in its tracks. We commend Congress for enacting this very important provision.

We also believe that the growth of automatic enrollment plans will substantially increase retirement plan participation by lower and middle income workers that are most likely to be induced to save by this type of plan design. Ninety percent of workers that are automatically enrolled chose not to opt out of the plan.[11] A 2005 ICI/EBRI study projects that that a lowest quartile worker reaching age 65 between 2030 and 2039 who participates in an automatic enrollment program with a 6% salary deferral (with no regard for an employer match) and investment in a life-cycle fund will have 401(k) assets adequate for 52% income replacement at retirement, not including social security that provides another 52% income replacement under today's structure.[12]

The important automatic enrollment provisions in the Pension Protection Act are already producing results. In the latest PSCA survey of 2006 plan year experience, 23.6% of plans have automatic enrollment, compared to 16.9% in 2005, 10.5% in 2004, and 8.4% in 2003. 41% of plans with more 5,000 or more participants reported utilizing automatic enrollment in our survey. A recent Hewitt survey indicated that 36% of respondents offered automatic enrollment in 2007, up from 24% in 2006. 55% of the other respondents are "very likely or somewhat likely" to offer automatic enrollment in 2007.[13] Vanguard reports that 80% percent of plans that implemented automatic enrollment in 2007 elected a "full autopilot design" that includes automatic deferral increases, a marked departure from earlier automatic enrollment plans.[14]

[10] *National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2007*, U.S. Department of Labor, August 2007.

[11] *Hewitt Study Reveals Impact of Automatic Enrollment on Employees' Retirement Savings Habits*, Hewitt Associates, October 25, 2006.

[12] *The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement*, EBRI Issue Brief no. 238, July 2005..

[13] *Survey Findings: Hot Topics in Retirement 2007*, Hewitt Associates

[14] *How America Saves 2007*, Vanguard

DOL REGULATORY FEE AGENDA

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**.

We believe that the regulatory scheme of soliciting input and issuing proposed and final rules based on comments from all affected parties will result in carefully-structured rules that will avoid unintended consequences. Moreover, regulatory guidance is dynamic. It can be more readily clarified and amended to adapt to changing conditions. Legislation, on the other hand, is cast in stone until changed, and change can be very difficult to enact for reasons totally unrelated to core issues when pension issues are consolidated into larger bills.

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, in the very near future. The modifications will significantly expand fee disclosure to plan sponsors, including all asset-based fees and service provider revenue-sharing. The final regulations implementing the new Form 5500 are expected to first be applicable to the 2009 plan year. The DOL will also require that the Form 5500 be filed electronically for plan years beginning in 2009. This change will make it possible for extensive "data-mining" of the expanded fee information in the revised Form in a short period of time. We expect that this new information will be very useful for fee benchmarking that it will help reduce some plan fees.

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. We filed individual comments and also all issued a joint response with seven other trade associations. The 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.

THE ERISA FRAMEWORK

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. For example, if a person buys a car, they don't need to know the price of the engine if it were sold separately. They do need to know the horsepower and warranty. Small business in particular may prefer the simplicity of a bundled fee arrangement. Congress should consider the need to increase plan sponsorship by small business if it considers legislating changes to bundled fee disclosure arrangements.

It is important that as it considers new legislation, Congress fully understand the realities of fees in 401(k) plans. There are significant recordkeeping, administrative, and compliance costs related to an employer provided plan, which do not exist for individual retail investors. And net performance compared to an appropriate benchmark is more important than a fund's investment management fees. Nevertheless, 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 Investment Company Institute reports that the average overall investment fee for stock mutual funds is 1.5% and that 401(k) investors pay half that amount.[15] 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. Congress should also realize that employer provided plans are often the only avenue of mutual fund investment available to lower-paid individuals who have great difficulty accumulating the minimum amounts necessary to begin investing in a mutual fund or to make subsequent investments. Finally, to the degree an employer provides a matching contribution, and most plans do, the plan participant is receiving an extraordinarily higher rate of return on their investment that a retail product cannot provide.

A study by CEM Benchmarking Inc. of 88 U.S. 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 considers any legislation to enhance disclosure of these fees, that they fully understand the lower-than-retail fees many employees are already enjoying in their 401(k) plans.

PRINCIPLES OF REFORM

As we stated earlier, we do not oppose effective and efficient disclosure efforts. We believe that the following principles should be embodied in any effort to enhance fee disclosure in employer-provided retirement plans.

- **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

[15] *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, 2006, Investment Company Institute, September 2007.

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 Unnecessary to Determine Overall Fee Reasonableness.** We believe that the requirement to "unbundled" 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. The increased burden for small businesses could inhibit new plan growth.
- **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 401(k) fee-related legislation be measured against these 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 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.

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

Mr. MCDERMOTT. Ms. Tavares?

STATEMENT OF LISA A. TAVARES, ESQ., PARTNER, VENABLE, LLP

Ms. TAVARES. Good afternoon to the Members of the Committee. Thank you for inviting me to testify today. My name is Lisa Tavares, and I am a Partner in the Employee Benefits and Executive Compensation Group at the law firm of Venable, LLP, here in Washington, D.C. I have practiced employee benefits law for 12 years in both the public sector and in private practice. In private practice, I regularly advise retirement plan sponsors and administrators of all sizes about their obligations under ERISA and the Internal Revenue Code.

Today, I was asked to provide my perspective on the real and practical day to day issues facing small- and medium-sized plan sponsors in two respects: First, in obtaining fee information from service providers; and, second, in providing fee information to participants.

My comments are not focused on the plan sponsors that I represent that can afford legal counsel, but are focused on those plan sponsors that have limited resources and tools to satisfy the multitude of requirements of ERISA. I am testifying on my own behalf and not on behalf of any particular client or clients.

The key points that I want to express are that many small- and medium-size plan sponsors currently do not have the tools to, one, effectively evaluate and compare plan fees in deciding between service providers or, two, to pass fee information along to plan participants.

Plan sponsors need investment and fee arrangement education, as well as cooperation from service providers in order to evaluate costs when choosing between service providers and to provide effective disclosure to plan participants regarding fees.

My testimony will cover four areas: First, the burden of the existing compliance requirements on plan sponsors; second, the difficulty in plan sponsors obtaining fee information; third, the necessity of uniform disclosure; and, fourth, the need to provide simplified disclosure to plan participants.

With respect to the existing burden of complying with ERISA and the Internal Revenue Code, many plan sponsors have become overburdened while trying to run their businesses. While plan sponsors do not have any excuse for failing to fulfill their fiduciary responsibility, in reality some plan sponsors simply do not know what the rules are. As a result of limited time, expertise and resources, some plan sponsors must rely solely upon the service providers to provide necessary plan compliance information. They turn to experienced legal counsel only when a big problem arises.

The second point is that it is also very difficult for the average plan sponsor to obtain fee information without the assistance of a professional investment consultant who can evaluate and identify what is behind the numbers. The most typical example that I can give is that of a plan sponsor who commonly receives a zero fee proposal. What this really means is that other administrative costs are being financed by investment fees charged on plan assets. However, some plans' sponsors do not realize that the plan is not in fact "free". Without assistance from an investment consultant, the plan sponsor may not be able to decipher fee proposals.

My third point is that I believe that uniform service provider disclosure might be the most useful way to assist the plan sponsor who cannot afford to hire an investment consultant to analyze this information. Any service provider disclosure provided to plan sponsors must be simple enough to be understood, but it must be sufficiently complete in order to enable the plan sponsor to evaluate whether to retain the service provider.

Finally, a fourth point about disclosure to participants: The Committee should consider the proper disclosure to plan participants given the fact that workforces are made up of employees with varying education levels who ultimately will all receive the same fee disclosure statement. To the extent this plan sponsor has to disclose fees to participants, the participant level notice must be simple enough to be understood by the average participant. Any legislative or regulatory action related to disclosure of fees must consider the existing burdens and obligations with respect to small- and medium-sized plan sponsors and must be coordinated with existing ERISA notice requirements in order to minimize new burdens.

In closing, the goal of any legislative or regulatory action should be to control cost for both participants and plan sponsors while balancing the need to provide necessary information to plan participants in an understandable format.

I am happy to take questions. Thank you.

[The prepared statement of Ms. Tavares follows:]

Statement of Lisa A. Tavares, Esq., Partner, Venable Law Firm, LLP

Good morning, Chairman Rangel and Committee members. Thank you for inviting me to testify today. My name is Lisa Tavares and I am a partner in the Employee Benefits and Executive Compensation Group at the law firm of Venable LLP in Washington, D.C. I have practiced employee benefits law for 12 years in both the public sector as an Attorney in the Office of Chief Counsel of the Internal Revenue Service, Tax Exempt and Government Entities, and now in private practice for 7 years. In private practice, I regularly advise retirement plan sponsors and administrators about their obligations under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and the Internal Revenue Code (the "Code").

The Employee Benefits and Executive Compensation Group of Venable represents employers of all sizes. The firm is the primary ERISA counsel for a number of small, medium and large public and private sector plan sponsors. And, of course, we represent numerous clients with respect to one-time issues.

I was asked to provide a perspective of a practitioner who works with small and medium size plan sponsors and to discuss the unique practical issues that small and medium size plan sponsors face in both obtaining fee disclosure from service providers and providing disclosure of fees to participants. My perspective on small and medium size employers is not predicated on surveys or commissioned analysis but is based upon a perspective of the real and practical day-to-day issues facing plan sponsors. My comments are not focused on my clients that can afford legal counsel, but are focused on those plan sponsors that have limited resources and tools to satisfy the multitude of ERISA and Code requirements. I am testifying on my own behalf, and not on behalf of any particular client or clients.

My testimony addresses the fact that plan sponsors need investment and fee arrangement education, as well as cooperation from service providers in order to evaluate costs when choosing service providers and to provide effective disclosure to plan participants regarding fees. My testimony will cover four areas: first, the burden of the existing compliance requirements on plan sponsors; second, the difficulty in plan sponsors obtaining fee information; third, the necessity for uniform disclosure; and fourth, the need to provide simplified disclosure to plan participants.

The key point that I want to express is that small and medium size plan sponsors currently do not have the tools to effectively evaluate and compare plan fees or the service provider marketplace. As a result, small and medium size plan sponsors cannot pass along plan fee information to participants.

Plan Sponsor Compliance Burden

Many have testified in various hearings that additional disclosure will ultimately mean greater cost to plan participants. However, it will also add to the costs of plan sponsors. The goal should be to control costs for both participants and plan sponsors while balancing the need to provide necessary information to plan participants in an understandable format.

Employers sponsor 401(k) plans [1] to help their employees save for retirement and to attract and retain employees. 401(k) plans are heavily regulated and impose significant fiduciary responsibilities on employers. As a result of the complexity of com-

[1] I will refer only to 401(k) plans in my testimony. However, similar considerations apply with respect to 403(b) plans and 457 plans.

plying with ERISA and the Code, some plan sponsors have become overburdened while trying to focus on running their businesses.

Plan sponsors are already feeling the burden of various disclosure and reporting requirements, to name the most common—summary plan descriptions, summary material modifications, summary annual reports, Form 5500 filings, safe harbor notices, and blackout notices.

As more employers sponsor plans, the 401(k) world has morphed into a "do-it-yourself" environment where plan sponsors have been encouraged to essentially purchase "off-the-shelf" prototype plans from service providers and operate them on auto-pilot. Overall, this serves the greater good because more employers can afford to sponsor plans for their employees. However, a natural by-product of this environment is the fact that a large number of plan sponsors turn to experienced employee benefits legal counsel only when a big problem arises.

As a result of limited time, expertise, and resources, some plan sponsors must rely solely upon service providers to provide necessary plan information. Of course, most of the service provider material clearly advises employers to consult with legal counsel; however, many plan sponsors simply do not have the budgets to obtain regular legal assistance with their 401(k) plans nor an appreciation for the special rules that apply to retirement plans.

Not surprisingly, the quality of service providers varies. Most do a good job of helping employers comply and enable employers to provide a 401(k) plan on a cost-effective basis, which otherwise would not be possible. Too often, however, with respect to fees, some service providers fail to give employers the full picture upfront.

I have worked extensively with 401(k) plans acquired through mergers and acquisitions, and through this experience I have seen for myself that many inexperienced plan sponsors simply do not have knowledge of the ERISA fiduciary requirements. Often times, plans with significant amounts of assets in a fast growing company will grow and thrive at a pace that exceeds the resources to handle the existing ERISA and Code requirements. During acquisitions, we find that plan documents are not in order and service contracts with fee information are not available. Based upon my experience with small plans picked up in acquisitions, it is obvious that some small unrepresented plan sponsors operating on a "do-it-yourself" basis are missing important legal requirements, including the responsibility to review and monitor plan fees. These well-meaning plan sponsors simply want to provide their valued employees with a mechanism for retirement savings.

While plan sponsors do not have any excuse for failing to fulfill their fiduciary responsibility, in reality, some plan sponsors simply do not know what the rules are. I acknowledge that additional fee disclosure is necessary, but it must be simple and have limited costs to be useful to both participants and plan sponsors.

In short, small plan sponsors would have to devote significant resources to comply with enhanced fee disclosures. This may have unintended and undesirable consequences of discouraging some small plan sponsors from sponsoring 401(k) plans.

Difficulty in Obtaining Fee Information

Many small or medium size plan sponsors will have great difficulty in preparing and providing 401(k) fee disclosure to participants without professional assistance, which is another cost for the plan sponsor. First, smaller plan sponsors may not be able to use asset size or number of participants to leverage the best fee arrangement.

It is also very difficult for the average plan sponsor to assess the structure of fees without the assistance of a professional investment consultant or adviser who can evaluate and identify what is behind the numbers, assuming complete numbers are provided. It is equally difficult for legal practitioners to assist their clients because the responses to Requests for Proposals or contract bids do not always include a complete analysis of all of the fees. Efforts to dig deeper and to obtain more detail as to fees may be met with resistance and, ultimately, the plan sponsor has to make a decision based on what information has been provided.

The most typical example that I can give is that of clients who commonly receive "zero fee" proposals. The only costs that may be listed are participant transaction fees such as plan loans, distributions or qualified domestic relations orders. What this means is that other administrative costs are being financed by investment fees charged on plan assets. However, many plan sponsors do not realize that. Even if they do, plan sponsors would have to ask specific questions in order to obtain information about the "hidden" fees. Similarly, if "bundled" services are involved, which is often the case, plans sponsors need to request a breakout of fees, which may be difficult to obtain.

The Department of Labor ("DOL") has done a good job of providing plan sponsors with publications regarding plan fees, including the 401(k) Plan Fee Disclosure Tool.

However, this is only useful for the plan sponsors who know that it exists and have the time, knowledge and skills to go through the process of doing a fee analysis. And even DOL publications can be too technical and complicated for an unsophisticated plan sponsor.

Plan sponsors also need education about the questions to ask to service providers. For example, the plan sponsor needs to ask service providers to compare per participant versus asset-based costs. The plan sponsor will need to ask the service provider about fees annually or negotiate a multi-year agreement. In my experience, a smaller plan sponsor also has to negotiate one-time fees such as setup fees and termination fees when switching providers or terminating plans. With respect to investment options, plan sponsors need to evaluate whether redemption fees or sales charges are assessed to specific investment options. It would also be useful for plan sponsors to request fee benchmarking comparisons for similar employers based upon plan asset size and number of participants. Most plan sponsors need an investment adviser to assist in fully obtaining this information and understanding it.

Uniform Disclosure

One of the current legislative proposals is to require service providers to provide fee information to plan administrators (i.e., the employer) in advance of a new contract. This would reduce the burden of deciphering the sales contract for the plan administrator who does not have the benefit of a professional investment adviser who understands fees and the pricing proposal in the current market. This proposed legislation also requires service providers to provide additional disclosure of the same types of information to plan sponsors each year of the contract.

The service provider disclosure provided to plan sponsors must be simple enough to be understood, but it must be sufficiently complete in order to enable the plan sponsor to evaluate whether to retain the service provider.

With an eye toward the “do-it-yourself” plan sponsor, a uniform disclosure format might be the most effective solution. Otherwise, some plan sponsors will still be forced to decipher the information themselves and provide disclosure on their own. This clearly would be more difficult for the plan sponsor who cannot afford to hire an investment consultant to analyze this information. A general notice prepared by the service provider would assist plan sponsors in understanding the service provider’s fees. In addition, to the extent the plan sponsor in turn has to disclose fees to participants, a similar notice prepared by the service provider could be used.

Simplified Disclosure Needed for Participants

The required disclosure statement for participants must be in a generic format and suitable to allow the average person responsible for day-to-day plan administration to be able to communicate to participants.

Effective participant communication drafting is a critical part of my practice and more importantly of a well-run and effective 401(k) plan. A communication with too much irrelevant information or unfamiliar terms will not serve participants well. I have learned that communications generally have to be limited to one or two pages in order to be effective. It would seem that a reasonable compromise would be to make more comprehensive information available upon request. Any disclosure must be brief and easy to understand.

One factor for consideration in determining the scope of the appropriate disclosure is the fact that employer workforces are made up of employees with varying education levels who ultimately will all receive the same fee disclosure statements. Outside of per participant fees for administrative costs and expense ratios for investment funds, it would generally be very difficult for a plan sponsor to provide fee information in an understandable format for the average participant.

It would also be very costly for small or medium size plan sponsors who want to provide adequate fee disclosure that could be understood by the entire workforce. Without a simplified disclosure document that is prepared by the service provider, the plan sponsor would need to hire outside assistance in order to comply with any participant level disclosure requirements.

Without a simplified format for disclosure, many participants may just receive additional information that they can not accurately interpret or effectively use to make decisions about the investment of their retirement benefits.

The Committee also should consider the need to coordinate any proposed fee disclosures with existing notice requirements, including benefits statements required by the Pension Protection Act of 2006. Without coordination, plan participants will be overwhelmed by various notices with different types of information.

Any legislative or regulatory action related to disclosure of fees must consider the existing burdens and obligations with respect to small and medium size plan sponsors. Such action must focus on the effective delivery of fee disclosure by service providers to plan sponsors who have the responsibility for providing simplified disclosure to plan participants.

Thank you for inviting me to testify. I am happy to take questions.

Mr. MCDERMOTT. Thank you very much.

Dr. Stein, how did you get to be a professor?

STATEMENT OF NORMAN P. STEIN, PROFESSOR, UNIVERSITY OF ALABAMA LAW SCHOOL, ON BEHALF OF THE PENSION RIGHTS CENTER

Mr. STEIN. We lawyers are fake professors.

Mr. MCDERMOTT. Okay.

Mr. STEIN. Mr. Chairman, Mr. McCrery, Mr. Johnson, I am Norman Stein, a Professor at the University of Alabama School of Law and this year I am a visiting professor at Catholic University here in Washington, D.C., which actually has been very nice for me because I have a son who just started at the Naval Academy, which is only 30 miles down the road.

I am appearing today on behalf of the Pension Rights Center, the Nation's only consumer organization dedicated solely to promoting and protecting the security of workers, retirees and their families. We thank you for the opportunity to testify today.

Our testimony today will focus on three issues: the effectiveness of fees on retirement savings and 401(k) plans, disclosure of fees to participants, and disclosure of fees to fiduciaries. Our written testimony covers three other issues, which we think are equally important, but not equally important enough to be included in our oral testimony.

In recent years, think tanks, commentators, consumer organizations, the government Accountability Office, '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), a small additional fee can result in substantial profits because that fee is typically multiplied by the number of participant accounts served and the total amount of assets managed. In many markets, a small percentage difference in the cost of a product or service is not particularly meaningful because it is a one time cost and is not compounded over time. But in the area of 401(k) plans, fees are charged periodically over an employee's working life, and the time value of money can turn a nominally insignificant fee into a significant loss in retirement savings. So, 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 period, can conceal the impact of fees. Participants, unaware of how much they were paying in fees, see their accounts grow and assume that they are earning significant returns.

Disclosure of fees is keenly important to participants. Participants need fee 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 decisionmakers' choice of investment options and, in some cases, the employees, the sophisticated employees, may be more focused on high fees than the decisionmakers themselves.

In our view, automatic participant disclosure should be simple, direct and uniform across investment options. We agree with the many people this morning who have said that too much information can overwhelm an unsophisticated participant and give even a financially literate participant more information than they need.

We suggest that the 401(k) participants be provided automatic fee disclosure statements that provide the following: A statement of why fees are important, and that they should be considered along with return and risk characteristics in selecting among investment options. For each investment option offered by the 401(k) plan, the rate of return net of fees during the preceding year, and an individual statement of the total dollar amount of fees charged to a participant's 401(k) account the preceding year, including all record keeping, investment load, marketing and other fees, perhaps broken down into two or three broad categories, as Mr. Neal's legislation suggests.

Participants need information to help them shape a portfolio from the investment options available under the plan. Plan decisionmakers, however, have to choose from the entire universe of available investment vehicles those options that will be made available to plan participants. Moreover, they need periodic information about the investments they have chosen in order to monitor their continuing appropriateness to the plan's participants. Thus, plan decisionmakers require detailed information about all fees that are charged to the plan so that they can compare one investment option to another, particularly within classes of investments and similarly to choose service providers.

In order for them to compare fees across various investment items and service providers, the presentation of fees should be uniform from vendor to vendor with fees divided into separate fees for each broad type of service provided by the vendor. This would require that fees for bundled services be unbundled.

We also note that we believe participants should be able to request, affirmatively request, any information on fees that is available to the plan.

Thank you for the opportunity to testify, and I of course am willing to take any questions.

[The prepared statement of Mr. Stein follows:]

Statement of Norman P. Stein, Professor, University of Alabama School of Law, on behalf of the Pension Rights Center

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 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 reconsidered 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] 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

[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

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 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.

Mr. MCDERMOTT. Thank you for your testimony, and we will go now to David Certner.

STATEMENT OF DAVID CERTNER, LEGISLATIVE COUNSEL AND LEGISLATIVE POLICY DIRECTOR, AARP

Mr. CERTNER. Mr. Chairman, Mr. McCrery, other Members of the Committee, thank you for convening this hearing today. AARP appreciates the opportunity to testify on this important retirement income issue. AARP believes that all workers need access to a retirement plan in addition to Social Security. In 2006, there were approximately 50 million active participants in 401(k) plans, now the dominant employer-based pension vehicle. Those participating in these plans shoulder the risk and responsibility for their investment choices and ultimately their retirement security. As a result, better plan information is essential. We all have a stake in ensuring that participants receive accurate and informative disclosure from the 401(k) plans, including expenses. However, plan expense and fee information is often scattered, difficult to access or non-existent. Meaningful information is vital because fees significantly reduce the assets available for retirement. Plan fees compound over time and the larger the fee, the bigger the reduction.

As earlier noted, GAO estimated that $20,000 left in a 401(k) account that had a one percentage point higher fee for 20 years would result in an over 17 percent reduction or over $10,000 in the account balance. But a more realistic period is a 30-year period, and we estimate that over a 30-year period, the account would be about 25 percent less. In other words, one out of every four plan dollars would go to fees. Even a difference of only half a percent or 50 basis points would reduce the value of the account by 13 percent over 30 years. In short, fees and expenses can have a huge impact on retirement income security levels.

AARP recently surveyed 401(k) participants to gauge their understanding of plan fees and investment choices. Our survey indicates that participants do not have a clear understanding of their investments. When asked if they know the names of all of the funds in which they have money invested, almost 65 percent of survey respondents said no. Twenty-7 percent did not know whether they had a stock fund, 29 percent did not know whether they even had a bond fund.

In addition, 401(k) participants lack basic knowledge of plan fees. When asked whether they pay any fees for their plans, less than one-fifth said they do, almost two thirds responded that they do not pay fees and 18 percent said they did not know. Respondents were questioned in detail about the fees they may be charged in mutual funds and other types of investments. The answers indicate that 401(k) participants do not fully understanding what types of fees their plans charge. For example, when asked whether their 401(k) plan charges an administrative fee, 24 percent said yes, 21 percent said no, 55 percent said they did not know.

Finally, Mr. Chairman, as you noted earlier, when told that plans often charge fees, 83 percent said they did not know how much they paid in fees. It is clear that better information is needed, and we applaud the Committee for taking a harder look at the need for acquiring greater transparency of fee and expense information for both participants and plan sponsors. To start, comprehensive information on plan fees and expenses will enable the plan sponsors to fulfill their fiduciary responsibility to ensure that fees and expenses are reasonable. Employers doing due diligence need to have access to costs associated with various components, not just total costs, and greater itemization of fee arrangements would provide a clearer presentation of cost. I agree with the comments of Mr. McCrery earlier today, that employers do have a key role to play, requiring that service providers give comprehensive information to plan sponsors, because is in turn important to the participants since the costs are often passed directly on to them.

Clear information is also necessary for the participants to better manage their own accounts. Participants face a range of fees, and while these fees vary in size and scope, they have one thing in common, they all reduce the level of assets available for retirement.

We support greater transparency to participants of plan investment choices, including the risks and fees, and believe all individual account plan participants need to have access to this information. Lack of participant knowledge and survey data suggests that fee information should be distributed on a regular basis and in plain language. We also recommend that information on an investment is demonstrated how they will affect the participant's account balance over time.

We commend the Committee for examining the need to strengthen 401(k) disclosure. The significant impact of fees on retirement security highlights the need for clear investment and fee information. Greater disclosure will help drive down fees, will enable plan sponsors and plan participants to be better consumers, and will ultimately lead to greater retirement income security.

We look forward to working with the Committee to ensure that employers and participants have the information they need. Thank you for the opportunity to testify. I will be happy to answer any questions.

[The prepared statement of Mr. Certner follows:]

AARP

TESTIMONY BEFORE THE

HOUSE COMMITTEE ON WAYS AND MEANS

ON

THE APPROPRIATENESS OF RETIREMENT PLAN FEES

October 30, 2007

WASHINGTON, D.C.

WITNESS: DAVID CERTNER
LEGISLATIVE COUNSEL &
LEGISLATIVE POLICY DIRECTOR

For further information
Contact: David Certner
Government Relations and Advocacy
(202) 434-3750

Mr. Chairman and members of the Committee, I am David Certner, Legislative Counsel and Legislative Policy Director at AARP. Thank you for convening this hearing on comprehensive, informative and timely disclosure of 401(k) plan investments and fees. AARP appreciates the opportunity to discuss this important retirement income security issue.

With more than 39 million members, AARP is the largest organization representing the interests of Americans age 50 and older and their families. About half of AARP members are working either full-time or part-time. All workers need access to a retirement plan that supplements Social Security's solid foundation. For those who participate in a defined contribution plan, such as a 401(k) plan, better and easy to understand information is essential to help them make sound plan decisions. This is especially true for plans in which the participants have investment choices to make. Informed decision-making is critical to future retirement income security.

There were approximately 50 million active participants in 401(k) plans in 2006, and overall, 401(k) plans are estimated to hold more than $2.7 trillion dollars in assets.[1] These plans have become the dominant employer-based pension vehicle. We all have a stake in ensuring that participants receive timely, accurate, and informative disclosures from their 401(k) plans – the better the understanding of how the plan operates, the better participants will be able to prepare for retirement. Today, it is clear that better disclosure of fee information is needed. The fee information participants currently receive about their plan is

[1] *EBRI Issue Brief No. 308, August 2007*

often scattered among several sources, difficult to access, or nonexistent. Even if it is accessible, plan investment and fee information is not always presented in a way that is meaningful to participants.

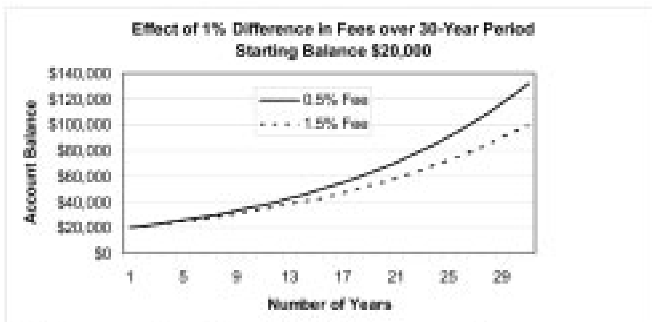
Meaningful and easy to understand information is vital because the fees and expenses charged to participants significantly reduce the amount of assets available for retirement. Plan fees compound over time and the larger the fee, the bigger the bite that is ultimately taken out of the participant's retirement nest egg. Both plan sponsors and participants need to have the right information in order to make decisions that safeguard the plan's retirement income returns and enhance workers' retirement savings.

Some have suggested that added focus on fees and expenses is not important, that such costs do not add up to a significant impact. After all, even an additional 1% in fees – 100 basis points – is only $1.00 out of every hundred dollars. But this argument understates the impact that fees and expenses have on total return, especially compounded over long periods of time.

The U.S. Government Accountability Office (GAO) recently estimated that $20,000 left in a 401(k) account for 20 years could grow to $70,555 at 7% interest return minus a 0.5 percent charge for fees (6.5% net return). The same $20,000 would grow to only about $58,400 if the annual fees are 1.5% (5.5% net return).[2] The one percentage age point fee differential has a dramatic impact –

[2] *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information*, GAO-07-21 (November 2006).

resulting in an over 17 percent reduction in the account balance over the 20-year period. Using GAO assumptions, AARP has estimated that over a longer 30-year period, the same $20,000 with a 0.5 percent charge would grow to $132,287, while a charge of 1.5 percent would reduce that growth to $99, 679 – about a 25 percent reduction in the account balance. Even a difference of only 50 basis points, from 0.5 percent to 1.0 percent, would reduce the value of the account by $17,417, or a little over 13 percent over the 30-year period.



The chart assumes a 7 percent rate of return before fees are assessed.

Clear, usable information about plan investments and fees will help plan sponsors fulfill their fiduciary responsibility and avoid potential fiduciary concerns. It is important that there be greater transparency of fees and other expense information in order for plan sponsors to make prudent choices. Employers are obligated to ensure that fees paid to service providers and other plan expenses are reasonable, and they are required to monitor these expenses over time. Employers doing due diligence need to have access to costs associated with various components, not just total costs. This responsibility is of great importance for participants, since costs are often passed directly on to them.

In order to better manage their own accounts, individuals also need greater disclosure to better understand the numerous fees and expenses in the plan. Participants face a range of potential fees, including plan administration fees, investment fees and fees for individual plan services. Within these categories are a range of potential fees. For example, plan investment choices may include sales charges and investment advisory fees. The level of these fees can vary greatly depending on plan size and service provided. But these fees all have one thing in common – they will reduce the level of assets available for retirement. Sound information can also provide participants with better tools to enforce their rights under the plan, including recovering lost benefits as a result of a breach of fiduciary duty. At least a dozen cases involving 401(k) fees have been filed in federal district courts, claiming fiduciary violations with respect to plan administration. The complaints center on allegations that 401(k) plans incurred unreasonable and excessive fees that were not adequately disclosed to participants.

AARP's Survey Results: Participants' Understanding of Fees

While plan participants have been asked to take on more risk and responsibility for their 401(k) plan, they often find the plan investment choices, as well as their associated fees and expenses, a mystery. AARP recently 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) providers and the factors they consider in selecting the investments offered by their plans. The report of the survey findings, "401(k) Participants' Awareness and Understanding of Fees, July 2007" [3] is available on the AARP website (AARP.org) and copies have been provided to the Committee. This report reveals that participants do not always have a clear grasp of the investment options offered by their plans or what they are invested in. When asked if they know the names of all the funds in which they have money invested through the 401(k) plan, almost 65% of survey respondents said no. And, when types of investments were described, survey respondents did not always know whether they had money in that investment. For example, 27% did not know whether their plan offered a stock fund and about as many, 29%, did not know whether their plan had a bond fund. 401(k) participants would benefit from additional information about the investment options in the plan.

When asked about the sources of information used to make investment decisions, 57% of respondents who make investment decisions for their 401(k)

[3] The survey was fielded from June 8th through June 24th, 2007 by Knowledge Networks of Menlo Park, California, to members of it's nationally representative on line panel.

plan indicate they refer to a summary of the plan's investment choices. Other sources include prospectuses (34%), research analysts' recommendations (22%), financial articles (17%), and televised financial broadcasts (14%). The fact that more than half of the respondents consulted the plan's summary of investment materials helps emphasize the importance of plan-provided summary information.

In addition, many 401(k) participants lack basic knowledge of the fees associated with their plan. When asked whether they pay any fees for their 401(k) plan, less than one-fifth (17%) said they do pay fees. Almost two-thirds responded that they do not pay fees (65%) and 18% stated that they do not know. Over half (55%) stated that they were not or not at all knowledgeable about the impact of fee on their total retirement savings, while 74% agreed that they wished they had a better understanding of the impact of fees.

When told that 401(k) providers often charge fees for administering the plans and that the fees may be paid by the employer as a sponsor or by the participants in the plan, 83% of those surveyed acknowledged that they do not know how much they pay in fees, while 17% said they did.

Respondents were questioned in some detail about the kinds of fees that may be charged for mutual funds and other types of investments. The answers indicate that 401(k) participants do not necessarily understand what types of fees their plans are charging. For example, when asked whether their 401(k) plan charged an administrative fee, 24% said yes, 21% said no, and 55% replied that they did not know. A similar question was posed about redemption fees. Seven percent of the survey respondents said they were charged a redemption fee, but 27% replied that they were not and 65% did not know.

When participants were provided possible definitions of an administrative and a redemption fee, 51% of the respondents correctly identified the administrative fee and 38% correctly identified the redemption fee. Approximately one third (37%) stated they did not know which statement correctly identified an administrative fee and more than half (55%) said they did not know which statement correctly identified a redemption fee.

AARP recommendations

AARP supports the efforts of interested members of Congress to address the appropriateness of retirement plan fees. We urge you to recognize the importance of providing comprehensive information to plan sponsors that could then be synthesized and given to participants along with required investment option information. In establishing greater itemization of different categories of fees, bundled service arrangements would essentially have to be un-bundled for clearer presentation of the costs. Requiring that plan service providers give more comprehensive information to plan sponsors will provide the plan sponsors with the resources they need to fulfill their fiduciary duties of due diligence in ensuring that plan fees are reasonable.

AARP recommends that information on an investment's fees demonstrate how they will affect the participant's account balance over time. Participants need to know how fees and expenses of an investment compare with others offered by the plan as well as similar investments in the market. GAO recently suggested that participants be provided the expense ratio for each investment as an effective way to compare fees, especially within the context of the investment's risk and historical performance.[4] 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.

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 also recommends including in the information furnished to participants whether employer stock is an investment option because the plan terms so provide. Too many employees continue to hold excessively large amounts of employer stock in their retirement plans. Clarifying why employer stock is among the available choices may help participants choose investments that reflect their

[4] *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information*, GAO-07-21 (November 2006).

personal goals, rather than reflect a value judgment about the return or risk associated with the employer stock. This information, which would complement the Pension Protection Act's provisions on disclosure and diversification, would add additional context to the information about employer stock that would help participants make a more informed decision.

Conclusion

AARP commends the committee for holding this hearing on retirement plan fees. The significant impact of fees on retirement security, as well as the results of AARP's survey of 401(k) participants, highlights the need for clear investment and fee information. We look forward to working with this Committee to ensure that both employers and participants have the information they need to best ensure an adequate retirement income level.

Thank you for the opportunity to testify today.

Mr. MCDERMOTT. Thank you very much. We will begin with Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. Ms. Tavares, you testified in support of limited and simple disclosure to plan sponsors so that they might evaluate costs and pass along the best deal to their employees. As you may be aware, I filed legislation to require all providers, including those that bundled services to disclose fees in broad categories, emphasis on the word "broad." Can you explain why you believe this disclosure is helpful and why it needs to be simple and low cost?

Ms. TAVARES. Well, first, I think "broad" and "simple" may work together. That was my intent.

Mr. NEAL. Mine too.

Ms. TAVARES. Okay. I think it would be helpful to the overall retirement system, in the voluntary system that exists, for employees to obtain information, but the cost could frustrate the system if a plan sponsor has to spend a lot of time deciphering detailed information that is not provided in the broad manner that you describe, in order to pass that information on the plan sponsor is going to have to hire someone to do that.

Mr. NEAL. Ms. Harris, you explained that some governmental plans already use independent consultants to assist in understanding plan fees; how can greater fee disclosure, even in the simple and broad manner that my bill outlines, assist those who manage 403(b) and 457 retirement plans?

Ms. HARRIS. Thank you. Can you repeat your question, please?

Mr. NEAL. I would be happy to. How can greater fee disclosure, even in simple and in the broad manner that my bill outlines, assist those who manage 403(b) and 457 retirement plans?

Ms. HARRIS. Speaking primarily on behalf of the 457 retirement plans, we found that some of the plans in our survey did use consultants and that was prevalent in the smaller State and local retirement plans. Our plans use the consultants to assist them in understanding the fee structures that the providers are presenting to them, and as part of our overall due diligence process. We take our fiduciary responsibilities so seriously, and we rely on the consultants because they have a better and broader knowledge of the fee industry than typically the smaller plans have. So, I think that if you require broader and simpler disclosure, then the plan administrators, such as myself and my colleagues, will perhaps not need to rely as much on the use of consultants, although it is part of our due diligence process, and we do include fee review as part of our fiduciary responsibility exercises.

Mr. NEAL. Thank you. Mr. Stein, I was interested in your recommendations regarding disclosure to workers. You recommend simple, direct disclosures, including annual personalized statements. This is similar, as you know, to the approach I have taken in my bill, and can you tell the Committee why you believe that while allowing access to more comprehensive information is necessary, for most workers hitting the highlights will be sufficient? This is very important?

Mr. STEIN. Yes, well, I want to make clear also that I think whatever information the plan has should be available to employees who request it, in part because I think part of the framework of ERISA is to essentially deputize employees to keep track of what is going on their employees and a few employees who do that job well can often have an impact on how the plan is administered. But generally, I agree that too much information can overwhelm an employee and basically what the employee needs is enough information, I think one of the earlier witnesses said, and I agree with this, whether to participate in the plan and presumably the fees will not be so high to discourage participation and, second, how to choose among various investment options. I do not think you need the same information that the plan sponsor needs to make the kinds of decisions the plan sponsor has to make.

Mr. MCDERMOTT. Mr. Johnson, would you like to inquire?

Mr. JOHNSON. Thank you, Mr. Chairman. Mr. Scott, TIAA has been successful in providing income, guaranteed income for life participants and great at getting people to participate in those plans. I know the defined contribution plans for teachers in Texas in particular have been very successful and popular. How do you help your customers make those crucial decisions?

Mr. SCOTT. I think there are several things that work in our favor here to make these plans successful, one is the fact that they are retirement focused, so people go into them with the understanding that this is about their retirement, so they tend to have a higher degree of interest based upon that. We do a significant amount of education through the employer and through our noncommission staff in addition to that. It is the employer and employee and the TIAA–CREF relationship that really makes that work, so they work. The employer works cooperatively with us to allow us access to the employees to help them educate them about their selection and the importance of selection.

The other thing is the employer contribution. There is a significant level of contribution in the 403(b) space, we think that is consistent with having a real retirement plan and that is what makes those programs work well, and objective advice, we believe we should be giving objective advice about fund selection so people can make the right choices about their retirement.

Mr. JOHNSON. Without government telling you to do it, right, you do it?

Mr. SCOTT. Well, so far that is the case.

Mr. JOHNSON. I know. I think that is good. Ms. Harris, when I was Chairman of the Subcommittee with jurisdiction over ERISA, I maintained that 403(b) plans and 457 plans are well regulated by State constitutions. If this Congress decides to legislate on top of all the State level regulation, could you review for us what special factors Congress ought to be careful to consider?

Ms. HARRIS. Well, I think that while we have not previously been subject to ERISA, we are subject to many layers of other laws, such as trust laws, open meetings laws, and public procurement laws. I said in my testimony, our contracts are most often reviewed in the open forum setting, so we have already an extremely high level of accountability to our participants. I can say that from where I come from, and I think my plan is very typical, we treat our participants as we as a governmental organization treat our taxpaying public. So, we do see that we have a very, very high level of accountability. We also look to ERISA for guidance and use that to develop our best practices and govern our plans by fairness and due process for the benefit of our participants. So, your question was what parts of ERISA should we——

Mr. JOHNSON. Do you think you ought to have any government interference in what you are doing right now or is the State oversight good enough?

Ms. HARRIS. Well, I think we already look to ERISA for guidance and then we have several more layers of oversight today. So, just like Mr. Scott, I think that we are already meeting most of the ERISA requirements that are imposed on a plan that is governed by ERISA.

Mr. JOHNSON. Okay, in the teacher venue, do most states require teachers to be participants of your plan?

Mr. SCOTT. That varies, a number of States have optional retirement programs that they allow teachers to participate in. Most of our participants are in universities and faculties and may or may not be in State-run programs.

Mr. JOHNSON. Okay, thank you. Mr. Wray, one question, do investors in a 401(k) plan generally pay more or less in investment fees than investors in the retail market when investing for their own discretionary saving?

Mr. WRAY. They actually pay less. In the current composition of 401(k) participation, about two thirds of the people work at companies with 1,000 or more employees. Those companies are able to negotiate the most favorable fee arrangements, so if you are looking at the system overall, they have very favorable fee outcomes as a general group.

Mr. JOHNSON. So, you would say that you do not think additional legislation or disclosure is necessary at this time?

Mr. WRAY. No, I think that we need to change the disclosure requirements, and we are very much in favor of that, and we are very supportive of the DOL efforts in this area. I was chair of the ERISA Advisory Council when the recommendations were made for the DOL to make changes in this area. We feel that the credibility of the system requires that all the players see what the fees are even though I think overall the system is providing a very favorable fee outcome in the system, that does not mean that we do not want disclosure because the credibility of the system really requires this I think.

Mr. JOHNSON. Okay.

Mr. WRAY. But not legislation at this point.

Mr. JOHNSON. Okay, thank you, sir. Thank you, Mr. Neal.

Mr. NEAL [presiding]. You were doing well until the last sentence.

[Laughter.]

Mr. JOHNSON. I kind of liked it.

Mr. NEAL. Let me thank the witnesses today for their testimony. There may be some written follow-up questions for panelists, and we appreciate your prompt response. This was most helpful to me, and I do appreciate the talent that you have demonstrated here today. If there are no further comments, the hearing stands adjourned.

[Whereupon, at 2:45 p.m., the hearing was adjourned.]

[Submissions for the Record follow:]

Statement of the American Council of Life Insurers

The American Council of Life Insurers (ACLI) appreciates the opportunity to provide our views to the Committee on Ways & Means in connection with the Committee's hearing on "The Appropriateness of Retirement Plan Fees." We welcome the interest of Chairman Rangel, Ranking Member McCrery and the Committee on this important topic. In addition, we also want to thank Congressman Neal and Larson for their interest in this issue by having introduced legislation which addresses disclosure in the defined contribution market. ACLI supports efforts to ensure meaningful disclosure on retirement plan fees. Employers who sponsor defined contribution plans need to be fully informed of the fees for the services and investment products selected for their plans. Employee-participants need information on the investment products and related fees that are made available in their plans in order to decide how to invest their retirement savings.

ACLI is a national trade association of 373 member companies that account for 93 percent of the life insurance industry's total assets in the United States, 91 percent of life insurance premiums, and 95 percent of annuity considerations. In addition to life insurance and annuities, ACLI member companies offer pensions, including 401(k)s, long-term care insurance, disability income insurance and other retirement and financial protection products, as well as reinsurance.

Life insurers are among the nation's leaders in providing retirement security to American workers. Life insurers provide a wide variety of investment products to retirement plans that are designed to achieve competitive returns while retirement savings are accumulating and to provide guaranteed income once employees enter retirement. More than one-quarter of the assets in employer-based retirement plans are managed by life insurers. Life insurance companies, like mutual funds and other financial institutions, provide investment options and administrative services to retirement plans, including 401(k) plans and similar participant-directed plans. In addition to managing the plan's investments, the insurer may offer other services to assist with plan administration, such as recordkeeping, participant communication, legal compliance and plan testing.

ACLI is committed to working with policy-makers to improve disclosure of plan information. In 2006, ACLI worked in conjunction with a group of trade associations to provide the Department of Labor (the "Department") with data on the types of fees charged in connection with retirement plan investment products and services. ACLI again recently joined with a broad group of trade associations in developing joint principles on fee disclosure in response to the Department's request for information. We look forward to continuing to work with the Department on its regulatory initiatives for participant disclosure. While ACLI may not agree with the Department on every point, we believe that the Department is addressing important issues with respect to plan fees. We hope the Congress will coordinate any legislative reforms with those regulatory initiatives that the Department has underway. It would be extremely disruptive to plan sponsors, service providers and participants if changes were made in response to new regulatory requirements only to be replaced by legislation imposing a different approach.

ACLI supports the following principles with respect to disclosure of plan information to plan sponsors and participants:

- **Fee disclosure to plan sponsors and to participants serve different needs.** The purposes behind fee disclosure to plan sponsors and to participants differ, and any reforms to the current-law rules should be consistent with those underlying differences. The selection and monitoring of service providers to the plan is a fiduciary act subject to ERISA-imposed obligations, including the obligation to ensure that fees paid from plan assets constitute reasonable compensation for services. By definition, a fiduciary needs full information about the services and products under the plan and the fees charged and compensation earned by plan service providers. Participants, on the other hand, are not selecting among service providers and setting provider compensation. Rather, participants are making a basic choice among a fixed menu of plan investment options, in which fees charged are only one of a number of important criteria for making sound investment decisions. Providing voluminous and granular information about plan fees to participants would add undue complexity and is not necessary to ensure that participants have the level of information they need to make decisions about their investment options. The distinct and different purposes between plan sponsor and plan participant fee disclosure must be kept squarely in mind in considering any new disclosure rules.
- **Disclosure to plan sponsors should focus on the information that plan sponsors need to fulfill their fiduciary responsibilities.** Fiduciaries need information as to the full menu of services and investment products that are

being provided to the plan and the aggregate fee for those services in order to fulfill their responsibilities under ERISA. Some plan sponsors may choose to purchase investment products and services in a "bundled" package under which a single fee may be charged for both investment products and other plan services. A 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. ACLI does not favor a so-called "unbundled" approach, which would require disclosure to plan sponsors that artificially divides a single "bundled" fee into specified components that the service provider may not make available commercially on a separate component basis. Requiring component disclosure is not necessary for the fiduciary to fulfill its obligations under ERISA and ensure that fees are reasonable. Moreover, requiring a "bundled" fee to be artificially divided among component services likely will lead to arbitrary results that will not provide useful information to plan sponsors.

- **Disclosure to plan participants should be designed to help focus participant decisions on how to invest their retirement assets.** Information that is irrelevant to participants' investment decisions may be confusing and increase costs, and therefore, should not be mandated. Fee and expense information is only part of the key information participants need in order to make investment decisions. Fee disclosure should not overshadow other critical information—such as investment objectives and product characteristics, historical performance and risks, and the identity of the investment advisor or product provider. Prior to enrollment, participants should be informed of their investment choices in simple, straightforward language. In addition to a description of the investment, participants should have access to a summary of expenses that could affect their account balances—including asset-based fees associated with the plan and its investment options, additional per-participant charges associated with the investment, and other administration fees and transaction charges. After enrollment, participants should be informed where to find or how to request updated information on fees and other characteristics of plan investment options.
- **Any new disclosure should be cost-effective.** Additional disclosure requirements come with added costs. Any new disclosure requirements will impose new expenses and burdens that are likely to be reflected in higher prices for plan administrative services, which would ultimately be borne by the plan participants. For some employers, new disclosure costs and related potential liabilities could even contribute to a reluctance to sponsor a qualified retirement plan for employees. It is therefore imperative that new disclosure requirements be cost-effective and focused squarely on providing information that is necessary for the decisions that need to be made under the plan. In that regard, plan sponsors should have the flexibility to determine the format in which the plan's investment options and fee structures are explained to participants, which should help minimize increased costs associated with any new disclosure requirements. Delivery of information to plan participants should be coordinated with current-law participant notice requirements and should to the greatest extent possible allow the use of electronic media.

* * * *

Life insurers are committed to meaningful disclosure, which is critical to ensuring secure retirements for the millions of Americans that participate in 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 on these important issues.

Statement of Daniel Wintz, Omaha, Nebraska

To the Committee:

Thank you for this opportunity to make a statement for the record regarding the appropriateness and disclosure of fees charged in connection with investments offered to participants in 401(k) plans.

My name is Daniel J. Wintz. I am an attorney with the Fraser Stryker PC LLO Law Firm, 409 South 17th Street, Omaha, Nebraska. I have been actively involved in the design and administration of qualified retirement plans since early 1975, shortly after the enactment of the Employee Retirement Income Security Act of 1974 (ERISA). My practice area has been and is primarily focused on advising employers maintaining, and fiduciaries serving, qualified retirement plans including 401(k), 403(b) and other defined contribution retirement plans providing for individual account investment direction.

I believe that, under ERISA, fiduciaries to and participants in 401(k) and other plans providing for investment direction need to be apprised of not only the total fees (as a percent of assets or otherwise) that will be incurred within a particular investment option, they also need to be apprised of four key elements that comprise that total fee; namely, investment adviser/management fees, plan administration fees (e.g., sub-Transfer Agent fees), sales/marketing fees (e.g., front-end, back-end, 12b-1, etc.), and investment overhead (i.e., other costs). Employers maintaining plans and fiduciaries serving plans need to know these respective fees in deciding whether particular investments are appropriate to be offered and whether the plan is paying no more than reasonable fees for services provided. Participants need to know these respective fees in order to determine the fees that they are paying versus possible returns, and to determine whether and how much they are willing to subsidize the cost of the administration of the plan and plan service providers.

For representatives of the investment industry to say that this information is difficult (or impossible) to provide or that it is information overload is simply ridiculous. If the information is difficult to obtain; whose fault is that? It is the investment industry's. If employers and fiduciaries are to evaluate this information in order to fulfill their duties under ERISA, isn't it appropriate that the investment industry be required to provide it? If a participant wants to make an informed decision about a particular investment versus another, shouldn't the participant know what (s)he is paying for in terms of investment management, plan administration, sales and overhead fess for respective investment alternatives? The obvious answer is, Of course.

I urge the Committee to report out a Bill that will mandate these minimum disclosures so that employers, fiduciaries and participants can make informed decisions with respect to investment alternatives offered through participant investment directed account plans.

If members or staff have any questions for me or would like additional information, please feel free to contact me. Thank you for this opportunity to make this statement.

Gerald C. Schneider and Judith M. Schneider, Letter

Bainbridge Island, Washington 98110
October 30, 2007

Ways and Means Committee
U.S. House of Representatives
Washington, DC

Members of the Committee:

Thank you for the opportunity to speak to the issue of hidden fees in retirement savings. For us, this has been as issue for many years since we hold a 401(k) with an insurance company and 403(b) products.

It took 20 years of working in schools and saving for retirement to become aware that hidden expenses torpedoed any chance at real growth in money saved through a 403(b). Once that became known, our staff had a chance to request better options through no-load funds. In our school district, it was a prolonged battle, because insurance and brokerage companies discouraged administrators and business office staff, who did not understand the issues around expenses.

When the 401(k) came into our life, we asked again and again about expenses and fees. The arrogance of the insurance company staff was evident when the representative said, “What do you care what the expenses are? Isn’t the value of the account going up?” Of course the value was increasing—due to a generally bullish market and continued contributions. They never, ever answered the questions about expenses and perhaps because few people asked, they felt they didn’t need to.

We regular working families must pass up travel, nicer housing, private schools, tutors for children, decent cars and other privileges and products in order to save for retirement. Having our returns stultified by excessive (and often hidden and unknown) expenses is an insult and a gross injustice. In our case, our retirement must come later and we believe it will be less secure as a result.

We hope you pass HR 3185 and EXPAND it to 403(b)s and 457s. We working folks need to know and deserve to know what the expenses and fees are—all of them. And we should have the opportunity to make the decisions about which services we need or how much is a fair price. We make those decisions in regard to our homes, our automobiles, our after-tax savings, and all the other services and products we use; we need and deserve the chance to make those decisions in regard to our retirement savings.

Thank you.

Gerald C. Schneider and Judith M. Schneider

Statement of Kevin Powell, Irvine, California

Members of the Committee,

It is a great honor to be afforded this opportunity. My name is Kevin Powell. I am a CFP (Certified Financial Planner) and a RIA (Registered Investment Advisor). I have worked in the financial services field since 1986. I feel that my testimony will be representative the “little guy” in America, since I talk to my clients (hard-working Americans) about retirement on a daily basis.

I strongly urge this committee not to limit its scope to just 401(k) plans. There are many other types of retirement plans in the American workplace today and there should be similar ground rules for all those plans. Addressing a problem for 401(k) plans and the larger corporations that normally offer them, while ignoring all the other retirement plans would be a terrible disservice to smaller employers & employees who many times will use another retirement plan such as a SIMPLE IRA, a SEP IRA, a 457, a 401(a) plan, a 403(b) plan, etc.

The majority of retirement plan savings is invested in mutual funds. Mutual funds have layers upon layers of fees, some disclosed and some that are hidden inside the fund. This makes it very difficult for investors when trying to approximate the actual amount of expenses that are being assessed inside a particular mutual fund. Without this information retirement plan participants are not able to make an educated decision as to where to place their hard-earned savings.

My primary concern about retirement plans and the fees that are assessed is that high fees inside the investment vehicles made available to plan participants, rob individual investors of hundreds of thousands if not millions of dollars over an average American’s lifetime.

It is likely that the Committee is going to see a variety of expense ratio charts and figures from other speakers who come forward to testify. However, please keep a couple of very important points in mind.

Disclosed mutual fund expense ratios averaged roughly 1.5% in 2006. That expense ratio *does not* include any sales loads or mortality and expense ratios (inside variable annuities) that investors may have had to pay. Yes, there are some retirement plans where investors have to pay these types of fees. Most importantly, it *does not* include the trading costs of the mutual fund that all investors pay. Recent estimates on trading cost expenses inside mutual funds were projected to be somewhere in the neighborhood of 0.5% to 1% or more annually.

The Investment Company Institute is a highly respected organization and their research is well recognized throughout our industry. Recent figures from their web site show 401(k) or retirement plan expenses averaged about 0.8% in 2006. If you add to this the undisclosed 0.5% trading cost expense (use the lowest projected cost to be conservative), you now have a truer expense ratio of about 1.3%.

Consider a simple scenario.

Assume that an investor is able to accumulate $500,000 in his or her retirement plan. If that investor averages an 8% return on those assets for 20 years, the account would grow to $2,330,478. For simplicity’s sake, assume no new additions or withdrawals from this fund for the illustrated time frame.

However, if that same investor could have earned a 9% return (by paying 1% less in expenses), he or she would have $2,802,205 or roughly 20% more in assets!

A simple 1% savings produces a difference of nearly one half of a million dollars. That's an extra half-million dollars for those retirement plan participants to use to fund their retirement, retire debt, and make purchases at local vendors that will support the regional and national economy, and so on.

That's also an extra $500,000 that will generate tax revenues for the U.S. government.

The following chart shows the differences in ending values of a $500,000 account invested at various growth rates for 20 years. You can easily see the differences in the ending values of the investments.

The purpose of the chart is to illustrate the difference in the ending values if retirement plan participants could save 1% in annual expenses. For example, compare the ending value from a 7% return to a 1% higher return of 8% that investors could realize through lower fees inside their retirement plan and so on.

Title

Starting value	Growth rate	Period of time	Ending value
$500,000	5%	20 years	$1,326,648
$500,000	6%	20 years	$1,603,567
$500,000	7%	20 years	$1,934,842
$500,000	8%	20 years	$2,330.478
$500,000	9%	20 years	$2,802,205
$500,000	10%	20 years	$3,363,749

What some of the greatest investment minds have said about investment fees?

A couple of the most intelligent investors we've ever known have spoken out on this subject. William F. Sharpe, Nobel Laureate in Economics, when asked about keys to investing, in a recent interview said: "*The **first** thing to look at is the expense ratio*" (italics & bold added).

This text was taken from Warren Buffett in the Berkshire-Hathaway Annual Report for 1996:

"*Seriously, costs matter. For example, equity mutual funds incur corporate expenses—largely payments to the funds' managers—that average about 100 basis points, a levy likely to cut the returns their investors earn by 10% or more over time.*"

Sadly, Mr. Buffett was too conservative in his calculations. The average equity fund now charges not 100, but 150 basis points, and also incurs portfolio transaction costs of at least another 50 basis points. Together, they comprise expenses of 200 basis points or more in some cases.

If I could amend Mr. Buffett's comments to reflect that fact, then fund costs are a "levy likely to cut the returns their investors earn by 20% or more over time."

And if you have to pay a sales load or management fee to buy or sell or manage your mutual fund, then your total returns will suffer even more.

Sadly—and unbelievably—bond fund expenses also average more than 1%, a grossly unjustified levy on any *gross* interest yield, especially with recent nominal yields in the 4.6% neighborhood on the long U.S. Treasury bond. When adding in all fees, returns would be cut by almost 30%. I believe investors should regard such costs as unacceptable and the government should step in to regulate this abuse.

If you want more evidence, consider this quote from the Securities and Exchange Commission's website:

"Higher expense funds do not, on average, perform better than lower expense funds."

Albert Einstein was once asked, "What is the most powerful force in the universe?" He replied, "Compound interest." Investors benefit from the power of that force when they invest for the long-term. But remember that when it comes to investment costs, the force can be equally powerful in the opposite direction.

Second area of focus beside investment fees

Retirement plan fees are a great starting point but should not be the only area of focus for the Committee. Further information from the Investment Company Institute's web site showed that retirement nest eggs reached a record $16.4 trillion in 2006, an 11% increase over the prior year and a 55% increase since 2002 when the equity bear market bottomed.

That is great news but also a bit disheartening. Since account values only grew by 11%, it means that most participants in retirement plans woefully underperformed the stock market in 2006 when compared to the overall stock market (S&P 500) return of 15.8%.

Considering new money added by employees and employers plus Americans who opened up a retirement plan for the first time and the earnings of all that new money, the real rate of return on retirement plans most likely was in the low to mid single digits. That could be roughly one-half of the nearly 16% return of the S&P 500. This is not a one-time anomaly either. This trend can be observed for a significant period of time.

So instead of earning an extra 1% as was illustrated above, some retirement plan participants could realize returns that were 4%-6% higher than what they have typically been earning! Using the investment growth chart from page 2, if you compare a 5% return to a 9% return (a difference of 4%), the result is $1.5 million more dollars for that retiree!

Possible solutions

1. Consistent rules and pricing guidelines

Part of this difference can come from establishing consistent pricing guidelines for mutual funds or other investment vehicles. Any investment company that offers services to any type of a retirement plan would have to offer a special set of funds that had pricing specifically for retirement plans.

I am not affiliated with any brokerage company but American Funds is a financial institution that I have a great deal of respect for. They have classified their funds into different levels. The fee differences on their "R" funds are striking. R5 funds are generally available to only retirement plans. For example, the American Fund Investment Company of America R1 mutual fund had a disclosed expense ratio of 1.42% compared to the R5 fund that had a 0.36% gross expense ratio. (Morningstar data July 2007)

That is the 1% difference that was illustrated in the original example and results in 20% more money for the plan participant.

However, the Committee has room to even improve on that this operational structure.

The R5 funds are only open to 401(k) plans. That means a large number of plan participants have to pay quite a bit more for the R4 funds or the R3 funds. For example, the internal expense ratio for the American Funds Investment Company of America R4 fund was roughly 80% higher than the R5 fund (0.65%). The R3 fund's gross expense ratio was disclosed as 0.95% or nearly 1.6 times higher than that of the R5 fund. And none of these expense ratios include any trading costs.

I believe you would see broad-based support for a mandate from the government for any company working with retirement plans that they have a class of retirement fund options for investors to consider that would be characterized by significantly lower fees inside the funds made available to all retirement plans. An expense ceiling formula should be included with this mandate. In other words, if the average expense ratio for the previous year was 1.5%, than all investment vehicles made available to retirement plans must have expense ratios that were 1% less than that ratio. Or whatever amount or percentage the Committee deems appropriate.

A flexible fee ceiling would allow for normal inflationary price increases or adjustments so financial companies would not suffer if costs increase in future years.

If investment companies wanted to offer their investment vehicles to the American public inside a retirement plan, they would have to have this class of lower cost funds available. The argument that financial institutions will go bankrupt or lose money is not valid since many companies besides American Funds are doing this very thing today and thriving in the market place.

If that type of argument is made, the Committee needs to remember that some of the largest costs mutual funds incur come from advertising, distribution and commission expenses. Advertising expenses are much less expensive with retirement plan participants when compared to investors in general because retirement plan participants normally have a set "menu" of funds to choose from. If a particular fund is not available inside a retirement plan, participants cannot go outside the plan and add funds of their own choosing.

Distribution and commission expenses are much less with retirement plans since all investment companies compensate their sales people significantly less on retirement plans than they do when compared to a regular sale of their funds. Distribution expenses are held in check because of the defined set of plan participants are limited to one enterprise or institution.

There are other investment alternatives that are significantly less expensive than traditional mutual funds. So there is the potential for an even greater savings to retirement plan participants.

Investment companies should be required to disclose *all fees* and a *total, all-inclusive fee ratio* for each fund they offer. That is the only way that investors will ever be able to do an "apples to apples" comparison of fund performance, expense ratios, etc. Since trading costs are not included in the current management expense ratio, investors who see an expense ratio of 0.8% are being terribly misled when in fact their total fee expense could easily be double that amount.

I am certain you are going to hear large institutions scream at this idea but it's the fair and right thing to do. I know those two words do not always make it to the final version of some laws but in this case, the Committee and our elected officials owe it to the American public to do all they can to see that they are included in any changes this Committee brings to the floor.

2. Education

The SEC and NASD do an exceptional job of investor education. While these are primarily governmental watchdog agencies responsible for policing agents and companies working with the public, they have done a very good job of promoting investor education.

The SEC has an awesome tool on their web site today that addresses expense ratios in funds and allows investors to compare two different investments based purely on a difference in fees. I strongly recommend members of the committee have staff go to this site and generate a couple of scenarios for themselves. (http://www.sec.gov/investor/tools/mfcc/mfcc-intsec.htm) The differences are shocking. So there are already some great educational tools in place. Plan participants just need to be made aware of this information.

The Committee should request that the SEC to expand their mutual fund cost tool to include other types of investments such as ETF's (exchange traded funds) and a wider array of mutual funds in the market place today.

I strongly encourage your committee to assign the SEC and/or NASD to devise a 401-k guide that must be distributed to all 401-k plan participants annually. Have a paper and electronic version available. Inside this guide, basic investment advice could be provided to plan participants to help them make them make an educated decision on the management of their plan dollars. It would have to be written in simple, everyday language. "*Legal-ease* " must not be included in the booklet. Fees, investment allocation, dollar cost averaging, investment risk, etc. can all easily be discussed in a non-threatening manner.

Every financial decision has consequences. There are good decisions and bad decisions, there are good and bad consequences to good decisions. There are also good and bad consequences with bad decisions. But usually the ratio of bad decisions producing a good consequence is very poor and if it does happen, it is called "luck." If the Committee, through its actions, can in some way inform the American public about these consequences and that solutions cannot be unto themselves, your work would have a profound impact on our society.

We are all concerned about the future of our country. What if through some very simple steps, your Committee could help increase retirement fund balances by two or three times what is currently in those plans? If you can reduce costs by 1% and increase returns by 3% or so annually through investor education and create a greater fiscal responsibility by all members of the financial services industry, these are some logical, possible results:

- The economy would surge with the new surplus of money in retirement plans. More assets to purchase more goods and services.
- GDP would soar to unbelievable levels from additional consumer spending.
- Consumer confidence would increase as a result of having so much more money in savings. Tax coffers would swell to record levels as Americans pulled additional funds from their retirement plans generating additional taxable income.
- Annual deficits would shrink or disappear entirely from the higher stream of tax revenues.
- The looming national debt crisis could have a realistic solution. Americans would have more funds with which to retire their ever-growing indebtedness.
- Trillions upon trillions of additional wealth would be created without anyone doing anything differently but operating on a more efficient level.

- Looming crisis' in Social Security and Medicare could be better addressed with this new pool of capital.
- Instead of debating tax increases to fund the many critical needs of our country, governmental leaders could have serious discussions about tax reductions or needed social reforms.

Most importantly, retirement plan participants would come closer to realizing the American dream of financial independence for themselves and their children. I challenge the Committee to make that your goal and legacy.

Thank you for this opportunity.

Respectfully submitted,

J. Kevin Powell, CFP
Certified Financial Planner
My Strategic Mentor, Inc.
Registered Investment Advisor

PS I would welcome the opportunity of testifying in person before the Committee as it considers these very important matters.

Statement of MassMutual, Springfield, Massachusetts

Massachusetts Mutual Life Insurance Company ("MassMutual") is pleased to submit this statement for the record in connection with the October 30, 2007 hearing of the House Committee on Ways & Means on the appropriateness of retirement plan fees. We believe this an important topic and we appreciate the commitment of Chairman Rangel and Ranking Member McCrery to address it in a thorough and considered way. We also very much appreciate the specific interest in this issue shown by Select Revenue Measures Subcommittee Chairman Neal as demonstrated by his recent introduction of the Defined Contribution Plan Fee Transparency Act of 2007 (H.R. 3765).

MassMutual is a mutually owned financial protection, accumulation and income management company with total assets under management in excess of $450 billion. We are a premier provider of life insurance, annuities, disability income insurance, long term care insurance, retirement planning products, income management and other products and services for individuals, business owners, and corporate and institutional markets. Specifically within the retirement services market, MassMutual Retirement Plan Services administers over 4,300 defined contribution plans covering more than 890,000 participants and representing $32.6 billion in assets. Our OppenheimerFunds subsidiary likewise has a very significant presence in the retirement plan marketplace, managing $52 billion in 401(k), 403(b), small business retirement plan and individual retirement product assets.

MassMutual believes that improvements in existing retirement plan fee disclosure standards can and should be made. Such reforms must be pursued, however, in a balanced and practical manner to ensure that we do not deter employees from plan participation or employers from plan sponsorship and to ensure that we do not, ironically, raise costs for the very employees we are seeking to safeguard.

MassMutual's History of Engagement and Business Improvement Regarding Fee Disclosure

MassMutual has a long history of advocacy in favor of comprehensive disclosure of fees to plan sponsors and participants. For more than a decade we have publicly recommended expanded fee disclosure. Specifically, we testified on behalf of expanded fee disclosure standards in 1996 before the Department of Labor's ERISA Advisory Council and again more recently in September 2004 before the same body. We likewise, in our own business practices, have sought to exceed legal requirements and to continually improve the fee disclosures we provide to our plan sponsor customers and to their plan participants. For example, we have continued to expand our disclosures to 401(k) sponsors regarding plan expenses, including of the payments made to compensate intermediaries (such as brokers and consultants) and the revenue sharing payments we receive from third parties. These detailed disclosures enable plan fiduciaries to more effectively fulfill their fiduciary duties and avoid the potential for conflicts of interest. We also just completed implementation of improvements to the benefit statements we provide to plan participants to make the fee and other information about plan investment options even clearer and more comprehensible.

Recommended Approach for Fee Disclosures to Plan Sponsors and Participants

Building on this history of policy engagement and continuous business practice improvement, MassMutual continues to support improved fee disclosure to both plan sponsors and plan participants and we welcome the attention to these issues by both legislators and regulators. We believe that reforms to current law should provide disclosures that are relevant, meaningful and cost-effective. As fiduciaries making the decisions on which plan providers to hire and what plan investment options and services to offer, plan sponsors need clear information on the fees charged for plan services, the specific services encompassed within a given provider contract and any revenues received by providers from outside parties.

We are concerned, however, that some may be seeking a particular provider disclosure regime as a way to tilt the marketplace toward a specific 401(k) service model. Many employers today prefer to work with a single "bundled" 401(k) plan service provider that offers all needed plan services for an easily reviewed aggregate fee. Under this arrangement, employers have only one entity to monitor and the responsibility of that service provider for the plan is clear. As bundled providers, MassMutual and OppenheimerFunds can assure the Committee that price competition among bundled service providers is fierce. Employers typically get multiple bids from such providers for the package of services they seek, a technique that assists employers in determining the reasonableness of the bundled fee, and regularly revisit the pricing of the bundled package of services. Yet certain providers seek to legally mandate the "unbundling" of both the services provided to plans and the prices associated with such services (even, ironically, when providers do not sell such services separately). We believe forcing bundled providers to unbundle their services and prices will be costly, will result in unhelpful artificiality of price information and will push all employers toward a single unbundled service model that many have not preferred.

Turning to the question of participant disclosure, it is clear that the disclosure needs of plan participants are substantially different from those of plan fiduciaries. Participants use fee information (along with other relevant factors) to make several discrete judgments—whether to participate in a plan and what options to select from among a plan's investment menu. Unlike fiduciaries, participants are not selecting among service providers or overseeing these providers' compensation levels. Participant fee information that is too voluminous or too detailed could lead to inertia, deterring employees from participating in the plan, or to investment decisions driven solely by fee considerations (which could result in undue investment in such low-cost but undiversified options as money market or company stock funds). At its most basic, we strongly believe the benefits of specific new provider and participant disclosure requirements must be weighed against their costs. It would be unfortunate and ironic if in the effort to improve and streamline fee disclosures we added significant new costs that would reduce the dollars available for retirement benefits.

Commentary on Current Fee Disclosure Reform Initiatives

MassMutual is supportive of the Department of Labor's (DOL) current efforts to address retirement plan fee transparency through three distinct regulatory projects. These projects involve (1) expanded disclosure by plan sponsors to the federal government of the fees paid by the plan and its participants to service providers, (2) expanded disclosure by service providers to plan sponsor fiduciaries of the direct and indirect fees such providers receive, and (3) expanded disclosure to participants regarding the investment and administrative fees charged to them under the plan.

We also recognize that Members of Congress have shown interest in addressing some of these same topics through legislation. In this regard, it will be important that any legislative efforts be closely coordinated with the existing regulatory activity. It would be extremely counterproductive if one set of disclosure reforms were implemented only to be supplanted shortly thereafter by another set of reforms. The result would be significant cost and confusion for both plan sponsors and participants, undercutting the benefits of the reforms themselves and heightening the risk that plan participation and sponsorship could be deterred.

With regard to the specific legislation that has been introduced to date, we believe the legislation introduced by Representative Neal and cosponsored by Representative Larson (H.R. 3765), makes significant improvements to current law while avoiding many of the pitfalls of other recent legislative proposals. We are pleased, for example, that the Neal bill steers clear of mandating that certain investments be included in every 401(k) plan. Such a congressional directive would usurp the role of the plan fiduciary to select investments best suited to its particular workforce and would mark a radical shift in our pension law, which has historically focused on holding fiduciaries to high standards and a prudent process rather than forcing them to reach particular substantive outcomes.

Participants under the Neal bill would be provided with information about the fees associated with plan participation and plan investments prior to enrollment and would also receive an annual statement that provides information on their specific investments, their asset allocation and the fees applicable to their accounts. The bill avoids inundating participants with voluminous, complex and disaggregated fee information that does not assist with participation and investment decisions but runs the real risk of bewildering participants, prompting unwise investment decisions and deterring plan participation. The Neal bill would require plan service providers to disclose to plan fiduciaries the total fees charged under a contract, an itemized list of the services provided for such fees, payments made by the provider from plan revenues to third-party intermediaries and compensation received from unaffiliated service providers (known as revenue sharing). While the Neal bill would also require service providers to make pricing estimates as to several broad categories of included services, it would not force the extensive unbundling of services and fees that marks other recent legislative proposals. We have detailed above why we think such extensive unbundling interferes with the marketplace and would be counterproductive.

Conclusion

MassMutual very much looks forward to continuing to work closely with Chairman Rangel, Ranking Member McCrery, Representative Neal and all interested members of the Committee—as well as the regulators at the Department of Labor—in the effort to enhance retirement plan fee disclosure standards. If handled appropriately, this effort can serve as an opportunity to further strengthen a defined contribution system that is already performing admirably in assisting tens of millions of American families in building retirement security. But we must be deliberate and practical in this effort. Disclosure regimes could easily become inordinately complex and costly in which case they would only serve to undermine these families' retirement security. We surely must not take any steps that would deter American workers from what we all know is the prudent course: participating in employer defined contribution plans from as early an age as possible in order to benefit from the truly powerful combination of compound interest, tax incentives, fiduciary oversight and frequent employer contributions.

We appreciate the Committee's consideration of our views.

Statement of Matthew D. Hutcheson, Independent Pension Fiduciary

BACKGROUND

Retirement plans subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), carry with them special obligations, which are commonly referred to in the retirement industry as "Fiduciary Standards of Care." Both regulators [1] and private organizations [2] have produced helpful tools and resources to assist fiduciaries fulfill their important obligations.

Those fiduciary standards are in place to protect participants and beneficiaries from economic slippage caused by the casual, careless, or even imprudent actions of others. The concept of a fiduciary acting on behalf of those who do not possess the knowledge or ability to act for themselves is not new, and the importance of knowledgeable and fully informed fiduciaries has never been clearer than it is today.

Participants do not generally understand the fees and costs associated with the operation of their 401(k) (or similar plan),[3] but fiduciaries cannot use ignorance as an excuse.[4] However, no matter who is ultimately making the investment decisions, whether participants or fiduciaries, fees and costs must be both known and understood for the reasons that follow.

FUNDAMENTAL KNOWLEDGE FIDUCIARIES NEED

ERISA requires that fiduciaries possess an understanding of many fundamental elements of plan operation. For those fiduciaries charged with managing the costs

---

[1] An excellent tool for Fiduciaries; produced by the EBSA, called "eLaws—ERISA Fiduciary Advisor" http://www.dol.gov/elaws/ebsa/fiduciary/introduction.htm

[2] Fiduciary Standards of Care promulgated by the Foundation for Fiduciary Studies. http://www.fi360.com/main/pdf/handbook_steward.pdf

[3] AARP study on awareness of 401(k) fees. http://www.aarp.org/research/financial/investing/401k_fees.html

[4] Under ERISA, "a pure heart and an empty head are not enough" to avoid responsibility for fiduciary breaches. Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983)

and investments of a plan, four of those basic elements bear particular importance because they directly impact how much retirement income a participant may ultimately receive.

1. The first is an appropriate ***investment time horizon*** for the portfolio, which will assist the fiduciary in determining how much risk can be taken over an identified period of time.[5]

2. The second is the identification of a ***modeled rate of return*** (i.e. the investment return goal) the fiduciary deems necessary to fulfill the objectives of the Plan, and the incorporation of that identified modeled rate of return into an actual portfolio.[6]

3. The third is combining the appropriate time horizon with the investment return goal (modeled return) to identify an ***appropriate level of risk*** into the investment portfolio necessary to generate that rate of return.[7]

4. The fourth requires fiduciaries to ***know and understand the related fees and costs*** associated with the individual elements of a portfolio and the portfolio as a whole because there is an inverse relationship between fees/costs and net investment returns.[8]

Those four variables are equally important and interrelated elements of portfolio construction. An expectation of favorable long-term results is otherwise not possible. Any other approach is random guesswork.

Further, in the context of this discussion, those four prerequisites must exist in harmony with each other before a fiduciary can confidently assert they have met the high standard of care to which they are obligated to adhere. And those prerequisites are inextricably connected. Deficiencies in that prerequisite knowledge will likely alter the outcomes of the others, and their collective impact upon the portfolio as a whole.

Time horizons, risk tolerance levels, and required returns may change from time to time due to forces fiduciaries or participants cannot control. Participants can only control the time horizons by working longer or retiring earlier unless illness or other unforeseen events occur. The economy can experience unforeseen turbulence. Other influences can make it challenging to maintain a steady course with prerequisites one through three. That leaves one variable that can be known ahead of time and can be controlled; variable number four—fees and costs.

FEES—THE PRIMARY PREDICTOR OF LONG-TERM RESULTS

Fees and costs, being the only possible currently controllable of the four prerequisite variables, therefore become the primary indicator of long-term results, all other variables taken into proper consideration.

In other words, when fees and costs are not known and understood, the long-term rate of return will be less than expected.[9] To increase the return to the expected level, additional risks must then be taken—risks about which fiduciaries and par-

---

[5] PRUDENTLY DEFINED TIME HORIZONS AS DETERMINED BY FIDUCIARIES: ERISA § 404(a)(1)(B); 29 CFR § 2550.404a–1(b)(1)(A); 29 CFR § 2550.404a–1(b)(2)(A); *Metzler v Graham*, 112 F.3d 207, 20 EBC 2857 (5th Cir. 1997); Interpretive Bulletin 96–1, 29 CFR § 2509.96–1; HR Report No 1280, 93d Congress, 2d Session (1974)

[6] DEFINED MODELED/EXPECTED RETURN AS DETERMINED BY FIDUCIARIES: ERISA § 404(a)(1)(A) and (B). Regulations—29 CFR § 2550.404a–1(b)(1)(A); 29 CFR § 2550.404a–1(b)(2)(A); *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944); *Communications Satellite Corporation v. Federal Communications Commission*, 611 F.2d 883 (D.C. Cir. 1977)

[7] APPROPRIATE LEVEL OF RISK AS DETERMINED BY FIDUCIARIES: ERISA § 404(a)(1)(B). Regulations—29 CFR § 2550.404a–1(b)(1)(A); 29 CFR § 2550.404a–1(b)(2)(B)(iiii); *Laborers National Pension Fund v. Northern Trust Quantitative Advisors, Inc.*, 173 F.3d 313, 23 EBC. 1001 (5th Cir. 1999)

[8] FEES AND COSTS ARE KNOWN, ACCOUNTED FOR, AND MONITORED BY FIDUCIARIES: ERISA § 404(a)(1)(A)(i and ii); § 406(a)(1)(C); § 408(b)(2); *Liss v. Smith*, 991 F. Supp. 278 (SDNY 1998); Interpretive Bulletin 94–2, 29 CFR § 2509.94–2. § 2(a); § 7; OCC Interpretive Letter No 722 (March 12, 1996), citing the Restatement of Trusts 3d: Prudent Investor Rule § 227, comment m at 58 (1992). ERISA § 3(14)(B); § 404(a)(1)(A), (B) and (D); § 406(a); 29 CFR § 2550.408(b)(2); Booklet, A look at 401(k) Plan Fees, U.S. Dept. of Labor, Pension and Welfare Benefits Administration; DOL Advisory Opinion Letter 89 28A (9/25/89); Interpretive Bulletin 75–8, 29 CFR § 2509.75–8. ERISA § 404(a)(1)(A) and (B); § 406(a)(1); § 406(b)(1); § 406(b)(3); *Brock v. Robbins*, 830 F.2d 640, 8 EBC 2489 (7th Cir. 1987); DOL Advisory Opinion Letter 97–15A; DOL Advisory Opinion Letter 97–16A (5/22/97)

[9] Chairman Christopher Cox, Securities and Exchange Commission. "*Our financial services industries are able to* ***skim off*** *much more of the assets they handle than would be the case in a well-functioning market. The difference materially burdens an investor's annual expected return. And compounded over the retirement time horizon of even someone in his or her 50's, this can result in truly astronomical shortfalls.*" SEC Speech. Address to Mutual Fund Directors http://www.sec.gov/news/speech/2007/spch041207cc.htm

ticipants may be unaware, but which they must be aware to properly manage their portfolios. Those additional risks may require a longer time horizon to accomplish the objective. Riskier portfolios generally cost more due to the frequency of transactions and rebalancing. Thus, one variable influences the other, and around and around things go, creating the potential for a imbalance within this delicate system that is already subject to many other uncontrollable variables. How can a fiduciary fulfill their basic duties described in prerequisites one through four when there are so many moving targets and unknowns?

For example, if a fiduciary constructs what they believe to be a portfolio that will deliver a long-term rate of return of 10%, but they are unaware that there are hidden costs of an additional 1%, the actual net fee adjusted return will be 9%. Thus, to actually earn the 10% return, higher risks must be taken—possibly higher than what the fiduciary deems prudent.

Therefore, fees that are obscure, hidden, or to which fiduciaries and participants are simply ignorant, create new and unexpected risks that may not be appropriate for the plan. Those risks create an imbalance between other fiduciary obligations, and make those obligations virtually impossible to satisfy, as the identified returns, risks, time horizons, etc. are based upon partial relevant information, thereby distorting expected future outcomes.

An additional challenge created by fee opacity (unknown fees) creates is an environment where participants pay for services they do not receive. For example, in a conventional bundled plan, the incremental cost of providing a particular service may be 0.10% of each participant account balance per year. In conventionally priced bundled plans, all participants pay for the service whether they utilize that particular provision of the plan or not. This speaks directly to the issue of considering the appropriateness of retirement plan fees.

Expenses from the plan must pay for services that benefit the participants and beneficiaries. Expenses that are for services that do not benefit participants and beneficiaries are excessive, and may in fact be prohibited transactions.[10]

In other words, a fiduciary's failure to satisfy obligation four, at a minimum, undermines a fiduciary's obligation pursuant to obligations one through three and potentially other fundamental plan requirements.

BENEFITS HONORABLE DISCLOSURE

The benefits of full disclosure are therefore as follows:

1. The widespread lack of understanding[11] by retirement plan participants and fiduciaries alike will be brought under control.
2. Fiduciaries will be able to properly discharge their duties, unimpeded, as they will know what all fees and costs are in advance, where costs can be fully evaluated and decisions can be made responsibly to properly manage costs and increase returns when possible;
3. Participants, to the extent they construct their own portfolios, will have relevant knowledge of all four variables in their possession. They too will be empowered to participate meaningfully in the system as it is currently designed. In other words, they will be in possession of all of the knowledge necessary to build a secure retirement, not just part of it as they have previously had;
4. Fiduciaries and participants will have the information necessary to discern the difference between "reasonable" expenses, and "excessive" expenses. Many think in terms that fees must be either reasonable or excessive. In practice however, fees can be both reasonable and excessive at the same time. In other words, the concept that fees and expenses must be "reasonable" is too subjective and relative to be meaningful. Therefore, fees and expenses must be reasonable, and must also not be excessive, simultaneously. Fiduciaries and participants can determine the reasonableness of fees only if they know what the fees are during the decision process. Participants will therefore be enabled to choose to pay a reasonable fee for only those services they both need and want;
5. Confidence in the system will greatly improve, increasing employee participation; and,
6. The private retirement system will be embraced by those who do not have a plan due to concerns about opacity and fair business practices by the financial services industry.

---

[10] Unnecessary and excessive services are those being rendered that are not "*helpful to the plan*." 29 CFR § 2550.408(b)(2)

[11] AARP study on awareness of 401(k) fees. http://www.aarp.org/research/financial/investing/401k_fees.html

FORM DISCLOSURE

There has been much debate over the form full disclosure should take. The most obvious element of disclosure is that it must be comprehensive for all of the reasons stated above. Second, the fees should be, at a minimum, combined into two basic categories for reporting to participants. Investment related fees,[12] and administrative fees.[13] Third, a measuring stick against a standard that has met the test of time should be provided so participants can understand the difference between their actual returns and the returns they could have received had they met the standard. The third element is particularly valuable to the participants who do not have advanced financial training. All of this should be easily understood by fiduciaries and participants at a glance. Participants must also be protected from paying for services they do not receive or benefit from, such as services that require underwriting from the whole plan, irrespective of the number of participants who actually utilize those services. This is an example of why bundled service providers must not, under any circumstance, be treated differently than their un-bundled service provider colleagues. There must be standardization in disclosure.

There are other aspects of disclosure that are critically important, such as whether conflicts of interest exist within plans, and the relationships service providers have with each other. If those relationships improve performance, increase efficiency, and facilitate operations, then the participants may greatly benefit. Then service providers can be proud of their mechanisms and relationships, and such disclosure will reveal the value added they purport to deliver.

Those service providers who have no conflicts of interests or special revenue sharing relationships with other service providers, including subsidiary or sister organizations, will simply have nothing to disclose. Such firms will not be affected by that element of the legislation.

SUPPORT HR 3185

I support HR 3185 and believe that it is sound legislation that addresses all of the relevant aspects of disclosure. It is comprehensive, it requires disclosure of other necessary aspects of plan operation such as the existence of conflicts of interest, and it places the interests of participants and beneficiaries first.

HR 3185 is sound legislation, and in its fundamentally unaltered form will right the ship in the 401(k) industry. While I am not opposed to a prohibited transaction tax as contemplated in HR 3765 per se, I believe ERISA as now written has adequate powers to assess monetary fines and penalties for failure to comply with the disclosure requirements of HR 3185.

I encourage the Committee to embrace HR 3185 in its fundamentally unaltered form. I believe that we will look back on this legislation in 10 or 20 years as a significant turning point toward protecting the retirement of America's middle class.

South Carolina Retirement Systems, Letter

South Carolina Retirement Systems
Columbia, South Carolina 29223
October 24, 2007

The Honorable Charles Rangel
Chairman, Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

---

[12] Sum of fund expense ratio, cost of clearing trades—i.e. brokerage commissions, other contract charges, commissions, shareholder servicing per head fees, early redemption fees, transfer/exchange/settlement costs, wrap fees, annuity fees and charges, investment advisor fees, and anything else related to the cost of delivering investment services, etc. Administration fees embedded in expense ratio or wrap investment fee must be extracted out and reported under the administrative fee category.

[13] Administrative fees charged to plan assets in addition to what the funds or investment products may charge. Per head charges, third party record keeper charges, custodial fees, professional fees passed through to plan assets. For example, a CPA or an attorney may submit an invoice to a plan sponsor for services rendered to a plan. If the plan sponsor passes such a bill on to plan participants, then it must be captured and reported. Other pass-throughs, such educational/advice fees, enrollment meeting fees/costs, travel, certain office and support staff fees, etc., and any miscellaneous fees or charges.

I am writing to you as director of the South Carolina Retirement Systems (Retirement Systems), which administers five defined benefit pension plans for public employees, to offer comments on H.R. 3361, a bill to make technical corrections to the "Pension Protection Act of 2006" (PPA). The Retirement Systems services more than 200,000 active members and in excess of 100,000 annuitants. Our members are from state government, public schools, institutions of higher education, and local governments.

I am submitting this letter on behalf of the Retirement Systems; however, South Carolina is not alone in facing these issues. As a member of the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement (NCTR), where I also serve on the NCTR executive committee, I can assure you that many other pension plans throughout the nation are affected by the provisions of the PPA discussed below, and are confronted with the same issues.

My comments relate to Section 845 of the PPA, which allows eligible retired public safety officers to elect to exclude from gross income up to $3,000 of certain distributions made from an eligible retirement plan to pay qualified health insurance premiums.

First, I want to commend you for correcting the guidance issued by the Internal Revenue Service (IRS) in its Notice 2007–7, Q&A 23, which stated that this exclusion did not apply to self-insured plans. This interpretation could have precluded otherwise eligible South Carolina public safety retirees from being able to participate in this new benefit, and I therefore support Section 9(i) of H.R. 3361 as introduced, which provides that the exclusion applies to coverage under an accident or health plan (rather than accident or health insurance), thereby permitting the exclusion to apply to self-insured plans as well as to insurance issued by an insurance company.

However, I would like to devote the bulk of my comments to a provision that I believe should be included in H.R. 3361, but does not appear there. Specifically, as explained further herein, I strongly urge you to add a provision to H.R. 3361 that would delete from Section 845 of the PPA the requirement that the exclusion shall only be available if payment of health plan premiums is made directly to the provider of the accident or health plan by deduction from a distribution from the public safety officer's retirement plan.

This requirement that premiums be paid directly to the insurance company has placed an undue administrative burden on the South Carolina Retirement Systems as well as many other retirement plans across the country. As background, the Retirement Systems provides benefits to a diverse employee base, covers many employee groups other than public safety officers, and does not currently identify employees as "public safety officers."

Therefore, in order to implement this benefit, the Retirement Systems has had to first develop a certification process to identify eligible members. Given that there are nearly 800 employers in the Retirement Systems' plans, identifying public safety officers accurately is difficult, particularly since many of these plan members have been retired for years, and employers have therefore often had difficulty in determining whether or not the member's last position was a public safety officer position. This has been further complicated by other portions of the PPA which provide a different definition of a public safety officer (PPA Section 828). The overall process, which has required direct individual communication with retirees and employers, is cumbersome and time consuming. It requires the expenditure of assets of the trust fund for the benefit of only a small sub-set of members, which also raises some fiduciary concerns for retirement systems administrators.

Next, the Retirement Systems must identify insurance companies with whom retirees have policies and must develop reporting and reconciliation requirements with them. However, as is the case with most public pension systems across the country, we do not administer retiree healthcare for South Carolina public employees. Retirement plans therefore may often have no control over the relationship between the retiree and the insurance provider. However, in order to offer this new benefit, retirement plans must become a conduit between them, caught in the middle of complex, often sensitive dealings between the insurance company and the retiree, such as cancelled policies, modified policies, refunded premiums, and increased premiums. It is no wonder that explaining the necessity of this arrangement to insurance carriers has been a challenge, and getting them to agree often difficult. I understand that in other states, some insurance companies have actually refused to agree to such an arrangement.

In short, tremendous time, effort, and resources are required to reconcile all of these events and properly track the health care benefit taken by our eligible members. As a consequence, the Retirement Systems has had to expend significant time and resources to gather membership data and modify existing information systems. In addition, we have hired additional personnel for the ongoing administration of these requirements. (Even though the IRS has recently indicated that reporting such amounts on retirees' Form 1099–Rs will not be required of us, the fact that payments must still be made from retirement systems directly to providers will require pension systems to continue to be middlemen in a complicated administrative process that is far removed from our primary responsibility, which is the provision of retirement benefits.)

Finally, adoption of the new benefit by a plan is optional and is also subject to being limited in scope. For example, I understand that in some cases, retirement plans can only deduct premiums for insurance provided by an employer or administered by the plan. However, there may be instances in which an employer provides a healthcare plan that is not administered by its retirement system, or where public safety members may be enrolled in a union-sponsored plan (if not for health benefits coverage, then perhaps for long-term care). Therefore, the continued mandatory involvement of retirement systems in this process can potentially delay and/or limit the use of the benefit by retirees who would otherwise be eligible to claim the exclusion but for the fact that the payment of health plan premiums is not made directly to the provider of the accident or health plan by deduction from a distribution from the public safety officer's retirement plan.

As I noted earlier, the IRS has now determined that retirement plans are not the entity that should properly make the decision that medical premium payments should be excluded from an individual's taxable income. Instead, the instructions regarding 1099–Rs and this new benefit make it clear that this is an election that should be made by the individual taxpayer. Therefore, given the undue administrative burden on pension plans, the added costs for taxpayers that could result, and the potential for limited and non-uniform application of the benefit for public safety retirees, there appears to be no good reason for the ongoing involvement of retirement systems in the administration of this benefit.

Thank you for this opportunity to express the views of the South Carolina Retirement Systems concerning H.R. 3361. While I appreciate the fact that the modification to Section 845 of the PPA that I am recommending may not be a purely technical matter, I believe that it is nonetheless a critically important correction that will preserve and enhance this important benefit for all involved.

Sincerely,

Peggy G. Boykin, CPA
Director

Statement of Wayne H. Miller, Denali Fiduciary Management, Vashon, Washington

Summary

ERISA is the federal law that governs the management of retirement plans. When a company that sponsors a retirement plan appoints a group of executives to manage the plan, those individuals are known as fiduciaries. The role of fiduciaries, first and foremost is to see that no one doing business with the retirement plan does harm to the plan's participants. The fiduciaries are supposed to serve as guardians on behalf of those people who have money in the retirement Trust.

In the overwhelming majority of cases fiduciaries work only a few hours every calendar quarter, receive little if any on-going training in the disciplines involved in their work, have no metrics with which to measure the success or failure of their plan management activities and are granted no compensation for their work regardless of its effectiveness. In the world of retirement plan fiduciaries there is virtually no personal accountability, no substantive oversight and no incentive to do a good job.

If this sounds like a recipe for a dysfunctional retirement plan system—it is. The last time we saw an economic system run like this we called it communism.

The Problem Isn't Technical

There are a myriad of technical issues ERISA retirement plan fiduciaries must know and understand to carry out their plan management responsibilities. Given the changes in the regulatory and capital markets over the past few years, the depth and breath to which technical issues must be examined has increased dramatically. For example, the concept of risk and its application to operations, investment management and plan governance is not the same in 2007 as it was in the year 2000.

These types of intellectual challenges notwithstanding, after 24 years of industry experience (having offered fiduciary advice and consulting on $100+ billion of retirement assets) it is very clear that the greatest obstacles fiduciaries face are not matters of technical competence. Though daunting in scope, such things can readily be learned. The greatest obstacles reflect the individual fiduciary's state of emotional intelligence (EI) and the dysfunctional behavior generated by the "group think" dynamics with which many fiduciary Committees operate.

Background: Incentives Count

Like it or not, in America's business culture, "honor" is not a highly prized incentive for influencing behavior. Any market based economist will tell you that other than by sheer luck the goals of any commercial activity are unlikely to be reached without properly structured incentives. In fact, without properly aligned incentives, all manner of extraneous actions will be adopted that are counter-productive to the intended purpose of the activity. For America's retirement system this is a big problem because other than for the "honor" of it, the American retirement system contains no incentives to encourage fiduciary excellence on the part of those people responsible for plan management. Worse yet, while the legal framework in which fiduciaries work imposes significant responsibility upon them, as a practical matter, they are not held to account for the quality of their work.

In any commercial endeavor where responsibility exists without individual accountability the result is a governance nightmare.

With no incentives or accountability embedded in the system to assure purposeful plan management practices, counter-productive behavior has become epidemic. This behavior impacts everything from plan operations and investment management to governance. There are many factors that have created this condition. For example, the bull market in the 1980's and 1990's created an environment in which everyone made money. From this success a culture developed in which little outside scrutiny was applied to those organizations that delivered services to retirement Plan Sponsors and their participants. During this period poor fiduciary habits became ingrained in common business practices.

Another influence that has fostered and promoted dysfunction in the retirement industry has come from the very vendor community whose conflicts of interest Congress intended to protect working Americans from. Despite such Congressional intent, plan management practices that explicitly or implicitly promote a vendor's economic interests have been commonplace. They have heavily influenced fiduciaries to the point that the spirit of fiduciary duty is commonly violated and no consequences are incurred by the violators or by those allowing such violations to occur.

If a retirement plan's fiduciaries are unfamiliar with or inattentive to the retirement plan's purpose had have no strategic plan in place by which all plan management practices are measured for their effectiveness at promoting that purpose, then ANY activity they engage in creates the *ILLUSION* of making progress in managing the plan.

This illusion is the natural consequence of a Plan Sponsor's fiduciary culture that lacks the intellectual rigor of establishing well-reasoned metrics to assess the efficiency or effectiveness of plan management practices. This illusion is the clinical manifestation of a dysfunctional fiduciary governance system. Such dysfunctional business practices would never be tolerated in the Plan Sponsor's core business. Any manager holding on to such delusional thinking rather than focused on project metrics that quantify progress toward goals would pay a price with their reputation and eventually their job.

The same principle that applies in core finance applications—if you aren't measuring it, it doesn't count—is applicable to fiduciary management as well.

Fiduciary Illusions and Emotional Intelligence

Emotional Intelligence was well recognized long before the term was coined.

Emotional Intelligence (EI) has been well documented and researched in the most elite of business publications such as the Harvard Business Review. A simple explanation of EI is "the self-awareness ***and*** acceptance which individuals have about the underlying motivation that drives their behavior". The state of each individual's EI is substantially derived from the emotional framework that shaped the formation of their personality.

An individual's EI, sometimes called EQ (like IQ), is not a purely static phenomenon, like height or eye color. It is dynamic within each of us and responsive to many types of stimuli. Each of us has the experience of witnessing a high level of EI in someone else even if we aren't used to calling it by that name. For example, we witness it when someone is willing to tell one on themselves—especially when those self deprecating comments are offered in a public forum. Such comments seem to have two components to them. First, the speaker recognizes that how they have dealt with that particular issue reflected a shortcoming in their character. Secondly, having self-acceptance that they have the shortcoming, the speaker can address the issue comfortably with others. They do not try to hide, mask or spin a story about it. There is no reason to do so as their shortcomings are not a source of emotional turmoil. This is what self acceptance brings—a release from shame, regret, sadness or angst.

To speak comfortably about one's shortcoming a speaker must emotionally reconcile the impact the shortcoming has had in their life. An audience listening to such a speaker will admire the sincerity of that individual. Those listening feel and respect the candor and authenticity of the person speaking. Listening to such commentary is inspiring and makes us want to be better.

By contrast, the absence of highly developed EI is also very familiar to all of us although it too is known by other names.

For example, take my friend Jim (not his real name). Jim is in his late 40's and lives in California with his 5th wife and two children. One day Jim called in a highly excited state. He had ***finally*** figured out "what it was with women". From the animation in his voice I could tell that Jim's revelation was profound for him. Having elaborated upon his discovery, I asked him if he recognized that HE was the only common ingredient in all of his five marriages. He was startled by the question and irritated by my interruption of his enthusiasm. Without hesitation, he dismissed the question, renewed his excitement and told me again of his A–HA moment.

Jim claimed to have discovered some principle regarding a pattern of behavior common to all of his wives. What he didn't realize was that the conclusion he reached deeply discounted his responsibility in understanding the dynamics of HIS relationships with women. In short, he ignored the contribution his personality made in the construction of his own life. He thought his discovery was all about *THEM*. He couldn't see that it really said more about *HIM*. He was blind to the vagaries of his emotional make up and the thought process derived from it—even though I'd bet big money that his four ex-wives weren't.

Had Jim been willing to ***reflect*** on the question, rather than ***deflect*** it, a powerful self-discovery might have been available to him. It might have changed his life. Alas, it would have to wait for another day. Jim had no idea of the gem he passed over. **Emotional blind spots are like that.**

Though very successful in business, Jim has a poorly developed EI when it comes to women. That's what having an emotional blind spot is; some aspect of your life for which you do not gather and process information that is otherwise visible to an independent and unattached observer. By definition, an emotional blind spot causes you to gather and interpret information in a manner that distorts the reality that an emotionally neutral person would have. Furthermore, the blind spot itself sustains the distortion until some other influence comes along with significant power to break up the illusion.

Emotional Blind Spots and Retirement and Plan Management

With no metrics to guide a self assessment regarding the quality of their own fiduciary conduct, "plan management" is more often a euphemism for benign neglect (or sometimes ignorance) than a conscious process engineered to produce a specific long-term result. This euphemism is sustained by a commonplace fiduciary culture that has as its fundamental premise "WE ARE GOOD PEOPLE HERE".

WE ARE GOOD PEOPLE HERE is a statement of identity. All too often, it is how fiduciaries think of themselves. The sentiment is used as a kind of emotional shield by fiduciaries to protect themselves individually and collectively from feeling badly about their conduct—regardless of the quality of their fiduciary conduct. Its unspoken acceptance as the cultural premise by a fiduciary committee limits the capacity of the fiduciaries to absorb any information that runs counter to the premise.

The author, never having met a malicious fiduciary, does not disagree with the statement that most fiduciaries are in fact well-meaning. However, being well-meaning is not a cause for celebration as to the quality of one's work. No experienced business person tells their boss that they are a well-meaning person and therefore, by virtue of that, they have done well at their job. However, this is exactly the emotional foundation with which most retirement plan fiduciaries operate.

Unless metrics are used to assess the effectiveness of plan management practices, WE ARE GOOD PEOPLE HERE is nothing short of a linguistic substitute for arrogance and neglect. It is an obstacle that reflects a pau-

city of sincerity relative to the solemn duty of watching after someone else's financial interests.

Though fiduciaries are morally and legally bound to serve in a guardianship capacity this group identity is the real (albeit unconscious) driver of their behavior. Its presence discourages an authentic self-examination or rigorous ***independent*** examination of the group's efficiency or effectiveness in the exercise of its duties. Though the goal of serving in a fiduciary capacity is to be of service to others and to apply the highest level of responsibility to acting in a guardianship capacity, a WE ARE GOOD PEOPLE HERE culture is ***all about the fiduciaries***. It is NOT about the quality of the job done on behalf of the plan participants they serve.

Organizational psychologists have a term for the behavior of smalls groups fueled by such a culture. It is "group think". In an ERISA fiduciary context WE ARE GOOD PEOPLE HERE is the clinical manifestation of group think. Such a culture thrives by deflecting any emotional challenge to the identity of the group. It operates as a kind of irresponsible creed: WE ARE GOOD PEOPLE HERE, that's how we know we do such a good job. If things don't work out—at least we meant well and that's what counts.

There are other emotional influences that also distort the purposefulness of a fiduciary's conduct in their individual capacities. Some of these influences are;

- the avoidance of blame,
- promoting the illusion of competency,
- the need for approval,
- the lack of self acceptance of making mistakes,
- the desire to look good,
- the willingness to acquiesce to the status quo rather than live out one's own values and last but not least . . .
- the lack of personal courage to speak out.

There are a multitude of plan management details impacted by these emotional biases that distort plan management priorities away from fiduciary excellence. Here are a few examples:

- **Fiduciaries often work with brokers or advisors but do not intimately understand the nature of the broker or advisor's relationship to the Trust's assets.** Process improvement is a credible goal of any long-term business endeavor. However, sustaining a reputation free of tarnished image or blame has a higher emotional priority in fiduciary management than conducting a rigorous examination of service vendors.

This is the primary reason why individual fiduciaries are not held to account for the fulfillment of various statutory duties. A fiduciary doesn't "own" the duty if they aren't accountable to someone for it. The implications for plan participants regarding investment costs, inappropriate investment vehicles and tainted investment advice are substantial.

- **The industry's major vendors are trusted without that trust being verified.** Because most fiduciaries serve in a part-time capacity, the vendors are relied upon to provide perspective and counsel on many mission critical plan management functions. Historically, that reliance was often mis-placed. Indeed, relative to the guardianship role, the duty of loyalty and the explicit duty to "monitor" parties in interest, the continuation of this reliance is inappropriate. In the real world, the economic best interests of vendors have often supplanted the economic best interests of the plan participants.

This is especially true in the new world of providing investment advice to plan participants. Few vendors can demonstrate that the advice they offer creates value. Very few can demonstrate that the advice they offer is valuable enough to pay for itself. If the service offers participant's comfort—fine—charge a hand holding fee instead of a percentage of the participant's account.

- The vendor's interest in life-style and life-cycle funds that "automate" the asset allocation decision based on a plan participant's age has embedded within it the self-interest the vendor has in maintaining the dominance of its investment management services in the 401(k) plan's menu. This is counter productive relative to a Best-of-Breed approach and has technical flaws relative to managing investment risks that are mission critical for older workers.

Regardless of the lofty principles embedded in ERISA, the de facto operating condition of the fiduciary landscape is not a pretty sight. With $10+ trillion of assets under ERISA's umbrella, such a dysfunctional culture is clearly inconsistent with the spirit if not the letter of fiduciary principles. Another description of such a culture is to say that it fosters and maintains a very low level of emotional intelligence. Candidly, it is self centered, inauthentic (relative to purpose), delusional (like Jim), self-assured and unfortunately in the American retirement plan industry—common practice.

This isn't to say everyone involved in the retirement plan industry is some kind of crook. Rather, this EI lens simply magnifies what everyone already knows. We all think in a manner that supports and validates our sense of Self and our economic interests—even when we have no metrics as to what value our activity has actually created.

Given the truth and gravity of this statement how can a retirement system, intended to represent the highest aspirations of trust and guardianship in law, recover a vision of its purpose and integrate the vision into the real world? Let's start with something radical; how about being authentic.

Systematic Fiduciary Governance: When Structure Supports Purpose

Responsibility without accountability has been the unspoken rule in ERISA. It is time that this change. The only credible solution to dysfunctional fiduciary conduct and the supporting cast of characters that promote it is to amend the current fiduciary governance practices of a retirement plan and install accountability that is visible to stakeholders at every segment of the plan management process.

There is no need to throw the entire system out. Rather, the efficiency of the entire system would be dramatically enhanced if a ***systematic and transparent*** approach to fiduciary governance were implemented and all industry players were held accountable for their piece of it. The average American worker would be the winner.

Limiting the Impact of Low Fiduciary EQ and Incentivizing High EQ

Let's go back to my friend Jim for a moment. He operated with an understanding of what was "wrong" with women and believed in the correctness of his perspective. He made his assessment and held it as truth because in his experience it ***was*** true. However, he reached his conclusion without including a self assessment as to how the vagaries of his own personality influenced his thought process and thus his conclusion. He just couldn't see it at the time ***and*** he didn't ask for an emotionally neutral (i.e., independent) pair of eyes to validate his hypothesis.

In similar fashion, most retirement fiduciaries and the support personnel around them do not engage in a critical self examination of their own conduct. Lacking a specific regulatory imperative to do so, initiating such an examination takes extraordinary courage. Investment managers, brokers, human resource fiduciaries, fiduciaries with a finance background, the attorneys and investment advisors who counsel fiduciaries, the Board members who serve as Appointing Fiduciaries and even the insurers who insure the above, all discount the contribution they make to supporting and sustaining dysfunctional fiduciary conduct within the industry. Everyone bears some amount of responsibility in the matter of this dysfunction.

All of these industry players have their reasons for doing what they do. Most of those reasons are related to their cash flow and market share. When all internal and external industry players are allowed to organize themselves in a manner such that no one is at the table speaking with a singular voice defending the interests of plan participants—the design of how the retirement security game gets played is fundamentally flawed.

When the maintenance of the status quo has a higher priority within the Plan Sponsor's fiduciary culture than does engineering more efficient or effective processes, something is wrong. The spirit of the fiduciary's duty has been subjugated. When fiduciaries give latitude to accommodate the self interest of service vendors a process has been initiated in which the incremental degradation of the duty becomes increasingly acceptable. **Only Rube Goldberg could be proud of such a convoluted architecture.**

So, What Is An Answer?

In creating an answer to the dilemma posed by a low fiduciary EQ, there are two realities one must address. First, the regulatory burden upon business is already substantial. Additional regulatory burden will be resisted and any backlash will diminish the opportunity for real change. Secondly, the effectiveness of the retirement system has been compromised for many years. Therefore, a solution that is years in the making runs the risk of being an ineffective band aid or a smoke screen, neither of which are useful relative to engineering an effective and efficient solution that promotes retirement security.

The author is suggesting that a genuine safe harbor against fiduciary liability be offered to the Plan Sponsor of a retirement plan IF and only IF the Sponsor adopts and can demonstrate the operational effectiveness of a governance process that assigns individual accountability for the fulfillment of all statutory fiduciary duties, establishes metrics which provide a credible assessment of the effectiveness of plan management practices and visibly incorporates the following components of governance transparency.

1. The Sponsor must collect separate written disclosures of the economic self-interest of each and every party upon whose advice, counsel or services they depend in executing plan management activities. These disclosures must be made available to Trust beneficiaries in their entirety and plan participants must be made aware that such disclosures are available.
2. The Sponsor must create, implement and make visible to all Trust beneficiaries written disclosures regarding the process of self examination and/or independent examination of the Sponsor's fiduciary conduct relative to the statutory fiduciary duties already existing in law. A self examination must make use of a thorough documentation system that has embedded within it a very high standard of fiduciary care.

If these components of a fiduciary governance system were visible to all stakeholders (the plan participant, the Sponsor's shareholders and the federal regulatory agencies that oversee retirement plans) the transparency of such information would have the natural effect of improving the quality of plan management. Only when such information is collected, disclosed and published will the dysfunctional behavior that has influenced the industry be mitigated.

If such a mandate was not contaminated by the self interests of the investment management community it would warrant the granting of a genuine, complete and comprehensive safe harbor from fiduciary liability by the regulatory authorities. That's right. Other than stealing money or explicit fraud, fiduciary liability would be a thing of the past. The notion of having multiple conditional safe harbors for Plan Sponsors as were offered in the Pension Protection Act of 2006 is of marginal utility relative to a blanket safe harbor which provides real protection based on meeting the requirements of a rigorous governance documentation process.

The safe harbor from fiduciary liability would be offered specifically to the appointing fiduciaries of the Board of Directors. By doing so, it would generate interest at a level of corporate leadership for which the fiduciary governance processes can receive the internal support to allow these plan management practices to flourish. By requiring that the self assessment be reviewed and approved by the Plan Sponsor's Board of Director's, an additional incentive would be incorporated into promoting checks and balances in fiduciary governance.

A missing link of the fiduciary system would be in place, operational and incentivized.

The adoption of these changes would create a system that is more authentic relative to its purpose than what we have now. Such a system would impose few if any costs on the Sponsor or plan participants because a template can be promoted that would serve as the foundation of the system. Various plan costs would be examined in a new light—one that exposes the economic self interest of all vendor support personnel and organizations. The impact of such sunshine cast upon plan management practices will make it easier for fiduciaries to carry the guardianship shield on behalf of those who trust them to do so.

With all of the really important information on the table rather than under the table, the marketplace will naturally reward the provider of high quality services that actually make a difference.

To remove communist-like ideology from the retirement plan business, to simplify the process by which a Plan Sponsor knows they are fulfilling their duty and to offer a genuine safe harbor that relieves liability are all worthy goals.

Implement this solution and plaintiff's counsel, service vendors who obfuscate value and Rube Goldberg will all have to find something else to smile about.

○