

GAO

Report to the Ranking Minority  
Member, Committee on Education and  
the Workforce, House of  
Representatives

November 2006

# PRIVATE PENSIONS

## Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees





Highlights of [GAO-07-21](#), a report to Ranking Member, Committee on Education and the Workforce, House of Representatives

### Why GAO Did This Study

American workers are increasingly relying on 401(k) plans, which allow pre-tax contributions to individual accounts, for their retirement income. As workers accrue earnings on their investments, they also pay a number of fees that may significantly decrease their retirement savings.

Because of concerns about the effects of fees on participants' retirement savings, GAO examined (1) the types of fees associated with 401(k) plans and who pays these fees, (2) how information on fees is disclosed to plan participants, and (3) how the Department of Labor (Labor) oversees plan fees and certain business arrangements. GAO reviewed industry surveys on fees and interviewed Labor officials and pension professionals about disclosure and reporting practices.

### What GAO Recommends

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 to plan sponsors the compensation providers receive from other service providers. In addition, GAO recommends that Labor require plan sponsors to report a summary of all fees paid out of plan assets or by participants. Labor generally agreed with the findings and conclusions of our report.

[www.gao.gov/cgi-bin/getrpt?GAO-07-21](http://www.gao.gov/cgi-bin/getrpt?GAO-07-21).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara Bobbjerg at (202) 512-7215 or [bovbjergb@gao.gov](mailto:bovbjergb@gao.gov).

## PRIVATE PENSIONS

# Changes Needed To Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees

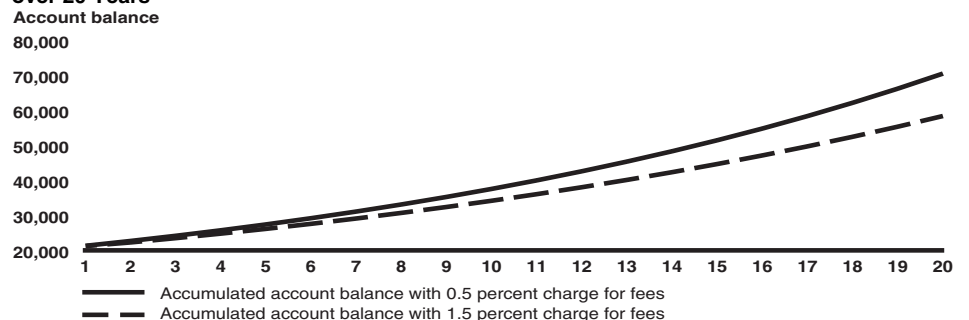
### What GAO Found

Investment fees, which are charged by companies managing mutual funds and other investment products for all services related to operating the fund, comprise the majority of fees in 401(k) plans and are typically borne by participants. Plan record-keeping fees generally account for the next largest portion of plan fees. These fees cover the cost of various administrative activities carried out to maintain participant accounts. Although plan sponsors often pay for record-keeping fees, participants bear them in a growing number of plans.

The information on fees that 401(k) plan sponsors are required by law to disclose is limited and does not provide for an easy comparison among investment options. The Employee Retirement Income Security Act of 1974 (ERISA) requires that plan sponsors provide participants with certain disclosure documents, but these documents are not required to contain information on fees borne by individual participants. Additional fee disclosures are required for certain—but not all—plans in which participants direct their investments. These disclosures are provided to participants in a piecemeal fashion and do not provide a simple way for participants to compare plan investment options and their fees.

Labor has authority under ERISA to oversee 401(k) plan fees and certain types of business arrangements that could affect fees, but lacks the information it needs to provide effective oversight. Labor collects information on fees from plan sponsors, investigates participants' complaints or referrals from other agencies on questionable 401(k) plan practices, and conducts outreach to educate plan sponsors about their responsibilities. However, the information reported to Labor does not include all fees charged to 401(k) plans and therefore has limited use for effective oversight and for identifying undisclosed business arrangements among service providers. Without disclosing these arrangements, service providers may steer plan sponsors toward investment products or services that may not be in the best interest of participants and may cause them to pay higher fees. Labor has several initiatives underway to improve the information it has on fees and the various business arrangements among service providers.

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



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## Abbreviations

AARP	American Association of Retired Persons
EBSA	Employee Benefits Security Administration
ERISA	Employee Retirement Income Security Act
FDIC	Federal Deposit Insurance Corporation
FRB	Federal Reserve Board
NASD	National Association of Securities Dealers, Inc.
OCC	Office of the Comptroller of the Currency
PSCA	Profit Sharing/401(k) Council of America
SEC	Securities and Exchange Commission

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United States Government Accountability Office  
Washington, DC 20548

November 16, 2006

The Honorable George Miller  
Ranking Minority Member  
Committee on Education and the  
Workforce  
House of Representatives

Dear Mr. Miller:

American workers are increasingly relying on 401(k) plans for their retirement incomes. Named after section 401(k) of the Internal Revenue Code, 401(k) plans are private pension plans that allow workers to save for retirement by diverting a portion of their pre-tax income into an investment account that can grow tax-free until withdrawn in retirement. Participation in 401(k) plans rose from fewer than 8 million participants in the mid-1980s to about 47 million participants in 2005, and assets in these plans increased by more than twenty fold during the same period, from less than \$100 billion to more than \$2 trillion.<sup>1</sup> As workers accrue earnings on their investments, they also pay a number of fees, including expenses, commissions, or other charges associated with operating a 401(k) plan.

Fees are one of many factors—such as the historical performance and investment risk for each plan option—participants should consider when investing in a 401(k) plan because fees can significantly decrease retirement savings over the course of a career. 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. Concerns have been raised that employers sponsoring the plans and plan participants may not be aware of all of the fees being charged to them or whether companies providing services to the plan have undisclosed business arrangements with other service providers that could negatively affect participants. In light of the potential effects of fees on plan participants'

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<sup>1</sup>For 2005 estimates, see Sarah Holden and Jack VanDerhei, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2005," *Research Perspective*, vol. 12, no. 1, (2006).

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retirement savings, the Ranking Member of the House Committee on Education and the Workforce asked GAO to examine

- the types of fees associated with 401(k) plans and who pays these fees,
- how information on fees is disclosed to plan participants, and
- how the Department of Labor (Labor) oversees plan fees and certain types of business arrangements.

To identify the fees associated with 401(k) plans and how they are charged to plan sponsors and plan participants, we interviewed officials from Labor, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the Securities and Exchange Commission (SEC), and the Treasury Department's Office of the Comptroller of the Currency (OCC); met with service providers and other industry professionals; and collected information about the range of fees and how they are charged to plan sponsors and participants. We also reviewed several industry surveys of 401(k) sponsors. To examine how well fees are disclosed to participants, we identified the legal and regulatory disclosure requirements; met with 401(k) plan practitioners; and reviewed sample disclosure documents. To examine Labor's role in overseeing plan fees and any undisclosed business arrangements among service providers, we reviewed Labor's and other agencies' legal and regulatory authority and Labor's procedures for assuring that plans are meeting overall legal requirements, including the reporting of information on the form plan sponsors are required to submit to Labor, Form 5500. We also interviewed officials from four of Labor's field offices and reviewed Labor's current initiatives related to 401(k) plans. We conducted our review from January 2006 through October 2006 in accordance with generally accepted government auditing standards. See appendix I for more detail regarding our scope and methodology.

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## Results in Brief

Various fees are associated with 401(k) plans, but investment and record-keeping fees account for most 401(k) plan fees and are borne by both plan participants and sponsors. Investment fees—such as those charged by mutual fund advisors to select securities for the fund—account for the largest portion of total fees in most plans. For example, a 2005 industry survey estimated that investment fees made up about 80 to 99 percent of plan fees, depending on the number of participants in the plan. Plan record-keeping fees—those associated with maintaining participants'

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accounts, such as processing their fund selections and preparing and mailing account statements—are the second-largest portion of plan fees. There are a number of other fees associated with establishing and maintaining a plan, such as fees to communicate basic information about the plan to participants. However, these fees generally comprise a much smaller percentage of total plan fees than investment and plan record-keeping fees. Whether and how participants or plan sponsors pay these fees varies by the type of fee and the size of the 401(k) plan. Investment fees, which are usually charged as a fixed percentage of assets and deducted from investment returns, are typically borne by participants. Plan record-keeping fees are charged as a percentage of a participant's assets, a flat fee, or a combination of both. Although plan sponsors pay these fees in a considerable number of plans, they are increasingly being paid by participants.

The information on fees that the Employee Retirement Income Security Act (ERISA) of 1974<sup>2</sup> requires 401(k) plan sponsors to disclose is limited and does not provide an easy comparison of investment options. All 401(k) plans are required to provide information on plan operations, participant accounts, and the plan's financial status, which may include some information related to fees. ERISA also requires 401(k) plan sponsors that have elected liability protection from participants' investment decisions to provide additional fee information. Most 401(k) plan sponsors elect this protection and therefore must provide information such as transaction fees related to each available investment option. Other plans that do not elect this protection may also provide access to fee information via such documents as 401(k) account statements and fund prospectuses. According to industry professionals, because plan sponsors provide this information in a piecemeal fashion, participants may not receive a clear picture of the total fees that they pay. In order to get a complete picture of fees, participants must collect various documents over time and may be required to seek out some documents. Furthermore, the documents that participants receive do not provide a simple way for participants to compare fees—along with risk and historical performance—among the investment options in their 401(k) plan.

Labor has authority under ERISA to oversee 401(k) plan fees and certain types of business arrangements involving service providers, but lacks the information it needs to provide effective oversight. Under ERISA, Labor is

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<sup>2</sup>29 U.S.C. §§ 1001-1461.

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responsible for enforcing the requirements that plan sponsors (1) ensure that fees paid with plan assets are reasonable and for necessary services; (2) be prudent and diversify the plan's investments or, if plan sponsors elect liability protection, provide a broad range of investment choices for participants; and (3) report information known on certain business arrangements involving service providers. Labor does this in a number of ways, including collecting information on fees from plan sponsors, investigating participants' complaints or referrals from other agencies on questionable 401(k) plan practices, and conducting outreach to educate plan sponsors about their responsibilities. Despite the agency's efforts, the information reported to Labor, such as information reported on Form 5500, does not include all fees paid by 401(k) plans. For example, plan sponsors are not required to report mutual fund investment fees to Labor on the Form 5500 even though they receive this information from the mutual fund companies in the form of a prospectus. Without information on all fees, Labor's oversight is limited because it is unable to identify fees that may be questionable. In addition, Labor and plan sponsors may not have information on arrangements among service providers that, according to officials at Labor, could steer plan sponsors toward offering investment options that benefit service providers but may not be in the best interest of participants. For example, a service provider that assists a plan sponsor in selecting investment options for the plan may also be receiving compensation from mutual fund companies for recommending their funds. The service provider may not disclose this business arrangement to the plan sponsor, and as a result, participants may have more limited investment options and pay higher fees for these options than they otherwise would. Labor has several initiatives underway to improve the information it has on fees and the various business arrangements among service providers.

To ensure that plan participants, sponsors, and the Department of Labor have more information on the fees associated with 401(k) plans, Congress should consider amending ERISA to require all plan sponsors of participant-directed plans to disclose fee information on each 401(k) investment option to participants in a way that facilitates comparison among the options. In addition, Congress should consider amending ERISA to explicitly require 401(k) service providers to disclose to plan sponsors the compensation they receive from other service providers. Finally, to better enable Labor to effectively oversee 401(k) plan fees, we are recommending that the Secretary of Labor require plan sponsors to report a summary of all fees that are paid out of plan assets or by participants. In response to our draft report, Labor generally agreed with our findings and conclusions. Specifically, Labor stated that it will give



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careful consideration to GAO's recommendation that plans be required to provide a summary of all fees that are paid out of plan assets or by participants. Labor and SEC also provided technical comments on the draft, which we incorporated as appropriate.

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## Background

Roughly half of all workers participate in an employer-sponsored retirement, or pension, plan. Private sector pension plans are classified either as defined benefit or as 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. Examples of defined contribution plans include 401(k) plans, employee stock ownership plans, and profit-sharing plans.

Over the past two decades, there has been a noticeable shift by employers away from defined benefit plans to defined contribution plans. The most dominant and fastest growing defined contribution plans are 401(k) plans, which allow workers to choose to contribute a portion of their pre-tax compensation to the plan under section 401(k) of the Internal Revenue Code.<sup>3</sup> The use of 401(k) plans accelerated in the 1980s after the Treasury issued a ruling clarifying a new section of the tax code that allowed employers and employees to make pre-tax contributions, up to certain limits, to employees' individual accounts.

According to the most recent data from Labor, most 401(k) plans are participant-directed, meaning that a participant makes investment decisions about his or her own retirement plan contributions. About 87 percent of all 401(k) plans—covering 92 percent of all 401(k) plan participants and 91 percent of all 401(k) plan assets—generally allow participants to choose how much to invest, within federal limits, and to select from a menu of diversified investment options selected by the

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<sup>3</sup>26 U.S.C. § 401(k) sets out requirements for plans to qualify for tax-deferred treatment. Roth contributions to 401(k) plans were created under the Economic Growth and Tax Relief Reconciliation Act of 2001 effective for plan years beginning on or after January 1, 2006. This new account type was subsequently made permanent under the Pension Protection Act of 2006. Designated Roth contributions are a new type of contribution that can be accepted by new or existing 401(k) plans. If a plan adopts this feature, employees can designate some or all of their elective contributions as Roth contributions (which are included in gross income) rather than pre-tax elective contributions.

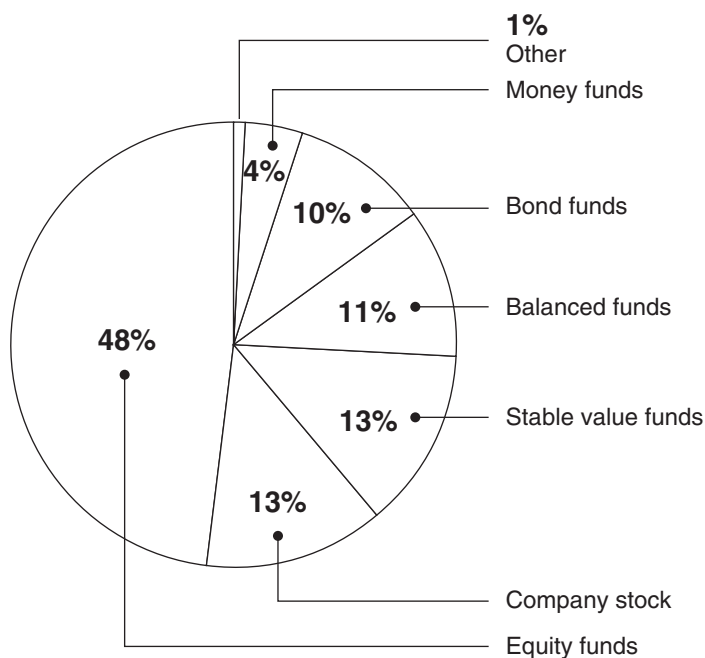
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employer sponsoring the plan, such as an assortment of mutual funds that include a mix of stocks, bonds, or money market investments.

Equity funds accounted for nearly half of the 401(k) plan assets at the close of 2005. Equity funds are investment options that invest primarily in stocks, such as mutual funds, bank collective funds,<sup>4</sup> life insurance separate accounts, and certain pooled investment products (see fig. 1). Other plan assets were invested in company stock; stable value funds,<sup>5</sup> including guaranteed investment contracts; balanced funds;<sup>6</sup> bond funds; and money funds.

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**Figure 1: 401(k) Plan Average Asset Allocation in 2005**



Source: Investment Company Institute.

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<sup>4</sup>A collective investment fund is a trust managed by a bank or trust company that pools investments of retirement plans or other large institutional investors.

<sup>5</sup>The stable value funds typically offered as 401(k) investment options by insurance companies and banks generally provide a guaranteed rate of return over a specific period of time, such as 3 to 5 years.

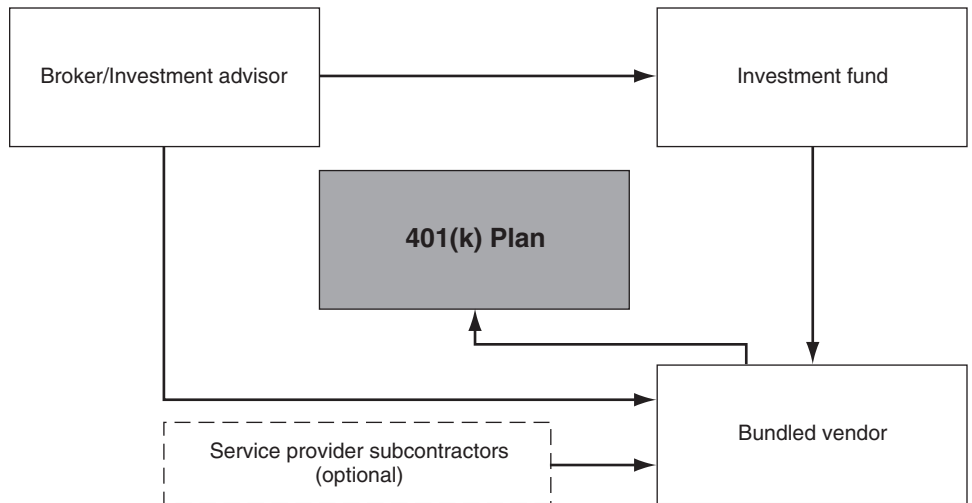
<sup>6</sup>Balanced funds are pooled accounts invested in both stocks and bonds.

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As participants accrue earnings on their investments, they also pay a number of fees, including expenses, commissions, or other charges associated with operating a 401(k) plan. Over the course of the employee's career, fees may significantly decrease retirement savings. For example, a 1-percentage point difference in fees can significantly reduce the amount of money saved for retirement. Assume an employee of 45 years of age with 20 years until retirement changes employers and leaves \$20,000 in a 401(k) account until retirement. If the average annual net return is 6.5 percent—a 7 percent investment return minus a 0.5 percent charge for fees—the \$20,000 will grow to about \$70,500 at retirement. However, if fees are instead 1.5 percent annually, the average net return is reduced to 5.5 percent, and the \$20,000 will grow to only about \$58,400. The additional 1 percent annual charge for fees would reduce the account balance at retirement by about 17 percent.

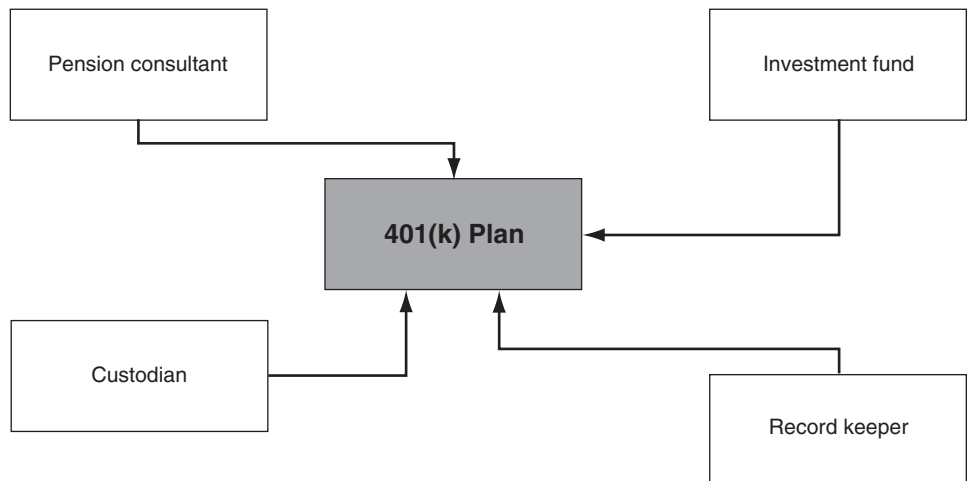
Fees are charged by the various outside companies that the plan sponsor—often the employer offering the 401(k) plan—hires to provide a number of services necessary to operate the plan. Services can include investment management (i.e., selecting and managing the securities included in a mutual fund); consulting and providing financial advice (i.e., selecting vendors for investment options or other services); record keeping (i.e., tracking individual account contributions); custodial or trustee services for plan assets (i.e., holding the plan assets in a bank); and telephone or Web-based customer services for participants. As shown in figures 2 and 3, generally there are two ways to provide services: “bundled” (the sponsor hires one company that provides the full range of services directly or through subcontracts) and “unbundled” (the sponsor uses a combination of service providers).

**Figure 2: Flow of Bundled Plan Services**



Source: GAO analysis of information from Profit Sharing/401(k) Council of America.

**Figure 3: Flow of Unbundled Plan Services**



Source: GAO analysis of information from Profit Sharing/401(k) Council of America.

Labor’s Employee Benefits Security Administration (EBSA) oversees 401(k) plans—including the fees associated with running the plans—because they are considered employee benefit plans under ERISA. Enacted before 401(k) plans came into wide use, ERISA establishes the responsibilities of employee benefit plan decision makers and the requirements for disclosing and reporting plan fees. Typically, the plan

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sponsor is a fiduciary.<sup>7</sup> A plan fiduciary includes a person who has discretionary control or authority over the management or administration of the plan, including the plan's assets. ERISA requires that plan sponsors responsible for managing employee benefit plans carry out their responsibilities prudently and do so solely in the interest of the plan's participants and beneficiaries.

The law also provides Labor with oversight authority of pension plans.<sup>8</sup> However, the specific investment products commonly contained in pension plans—such as company stock, mutual funds, collective investment funds, and group annuity contracts—fall under the authority of the applicable securities, banking, or insurance regulators.

- The SEC, among other responsibilities, regulates registered securities including company stock and mutual funds under securities law.<sup>9</sup>
- The federal agencies charged with oversight of banks—primarily FRB, OCC, and FDIC—regulate bank investment products, such as collective investment funds.
- State agencies generally regulate insurance products, such as variable annuity contracts. Such investment products may also include one or more insurance elements, which are not present in other investment options. Generally, these elements include an annuity feature, interest and expense guarantees, and any death benefit provided during the term of the contract.<sup>10</sup>

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<sup>7</sup>Any person who makes investment decisions with respect to a qualified employee benefit plan's assets is generally a fiduciary. The duties the person performs for the plan rather than their title or office determines whether that person is a plan fiduciary. 29 U.S.C. § 1002(21)(A).

<sup>8</sup>IRS also oversees various aspects of 401(k) contributions under the authority of the Internal Revenue Code.

<sup>9</sup>15 U.S.C. § 78a. Generally, public offerings and the sale of securities must be registered with the SEC.

<sup>10</sup>The variable annuity contract “wraps” around investment options, often a number of mutual funds. Participants select from among the investment options offered, and the returns to their individual accounts vary with their choice of investments. If registered securities make up the underlying investments, they are regulated by the SEC.

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An investment company, bank, or insurance company that is a service provider to a 401(k) plan may offer any or all of these types of investment products as plan options.

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## Investment Fees Account for Most 401(k) Plan Fees and Are Usually Borne by Plan Participants

Investment fees—which are charged by companies that manage mutual funds or other investment products for all services related to operating the fund—comprise the majority of fees in 401(k) plans and are typically borne by participants. Plan record-keeping fees generally account for the next largest portion of plan fees. These fees cover the cost of various administrative activities carried out to maintain participant accounts. Participants typically pay for investment fees, which are usually based on assets in their accounts. Although plan sponsors often pay for record-keeping fees, participants bear them in an increasing number of plans.

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## Investment Fees and Plan Record-Keeping Fees Together Account for Nearly All of Plan Fees

Investment fees and plan record-keeping fees comprise the vast majority of total plan fees. 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.<sup>11</sup> 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 market.<sup>12</sup> As such, the fees are usually different for each investment option available to participants in a 401(k) plan.

Investment fees account for the majority of 401(k) plan fees regardless of plan size. For example, as figure 4 illustrates, a 2005 industry survey

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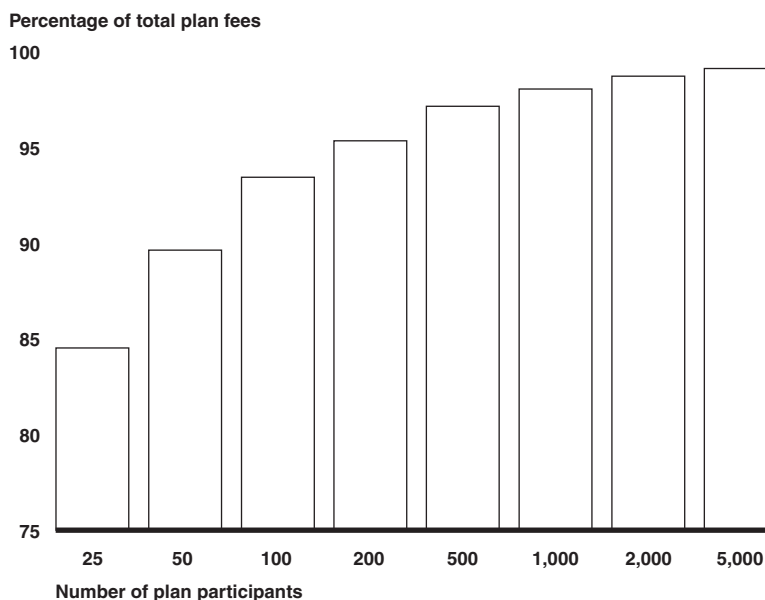
<sup>11</sup>Fees related to marketing and compensating brokers to sell the fund are known as 12b-1, or distribution fees, and are limited by the National Association of Securities Dealers, Inc. (NASD) to a maximum of 1 percentage point of the total expense ratio per year.

<sup>12</sup>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 NASD 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.

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estimated that investment fees accounted for 84.5 percent of total fees in plans with 25 members and for 98.6 percent of total fees in plans with 2,000 participants.

**Figure 4: Investment Fees as a Percentage of Total Plan Fees, 2005**



Source: HR Investment Consultants.

Since investment fees account for the bulk of plan fees, several investment consultants we interviewed encourage 401(k) plan sponsors to offer options such as institutional funds to lower fees. Institutional mutual funds resemble funds available in the retail market, but are typically only available to 401(k) plans with assets above a certain threshold, such as \$1 million. Similarly, indexed funds have lower management fees than actively managed funds. These funds closely track a market performance indicator, such as the Standard & Poor's 500, which largely eliminates expenditures associated with research, investment selection, and buying and selling.

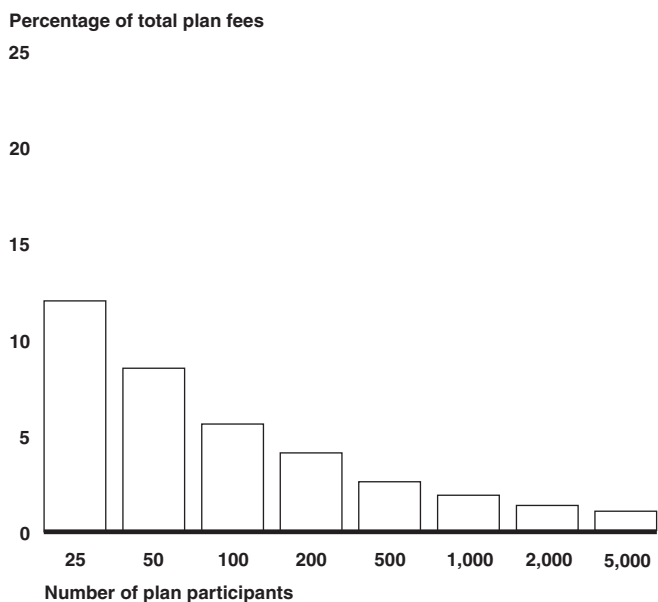
Plan record-keeping fees, which cover individual account maintenance for plan participants, generally constitute the second-largest portion of plan fees. Unlike investment fees, plan record-keeping fees apply to the entire 401(k) plan rather than the individual investment options. Plan record-keeping fees are usually charged by the service provider to set up and maintain the 401(k) plan. These fees cover a variety of activities such as enrolling plan participants, processing participant fund selections,

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preparing and mailing account statements, and other related administration activities.

A 2005 industry survey of service providers estimated that plan record-keeping fees constituted 12 percent of total plan fees for plans with 25 participants. As shown in figure 5, these fees make up a smaller proportion of total plan fees in larger plans, indicating economies of scale.

**Figure 5: Plan Record-Keeping Fees as a Percentage of Total Plan Fees, 2005**



Source: HR Investment Consultants.

Note: While these data include primarily record keeping, they include a negligible amount of other administrative fees, according to the survey's author.

In addition to investment and record-keeping fees, there are a number of other fees charged to administer the plan as a whole, including

- *trustee fees* that are charged by an individual, bank, or trust company to securely maintain plan assets;
- *audit fees* that are imposed by a service provider in connection with the annual audit that is required of ERISA-covered plans with more than 100 participants;
- *legal fees* that are charged by an attorney or law firm to provide legal support for administrative activities, such as ensuring the



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plan is in compliance with ERISA or representing the plan in a divorce settlement;

- *investment consulting fees* that are charged by an advisor, often a pension consultant, hired to help the plan sponsor select funds for the plan and to monitor investments; and
- *communication fees* that cover the cost of educating participants about the plan. Communication services may include a meeting led by a service provider to introduce the plan to participants. Communication services may also include providing participants with access to toll-free phone services, Internet service, and ongoing educational seminars.

These fees generally comprise a much smaller percentage of total plan fees than investment and plan record-keeping fees.

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### Participants Bear Most Investment Fees and an Increasing Number of Participants Bear Plan Record-Keeping Fees

Participants pay for the majority of investment fees and a greater number bear plan record-keeping fees. As shown in table 1, a 2005 industry survey of 401(k) plan sponsors found that plan participants paid investment fees in almost 62 percent of plans with 5,000 members or fewer. This arrangement was even more common in plans with over 5,000 members where participants bear investment fees in about 71 percent of all plans. For both size plans, plan sponsors and participants shared investment fees in about 10 percent to 12 percent of plans. Another industry survey of plan sponsors with 1,000 employees or more also found that plan participants paid investment fees in the majority of plans in 2005.

**Table 1: Payers of Major 401(k) Plan Fees, 2005**

	Plans with fewer than 5,000 participants			Plans with more than 5,000 participants		
	Participants (percent)	Sponsor (percent)	Participants and sponsors (percent)	Participants (percent)	Sponsor (percent)	Participants and sponsors (percent)
Investment fees	61.8	27.5	10.6	71.5	16.2	12.3
Plan record-keeping fees <sup>a</sup>	32.5	58.3	9.2	50.4	34.6	15.0
Audit fees	16.0	82.5	1.5	33.3	62.2	4.4
Communication to employees	20.0	70.5	9.5	34.3	49.6	16.1
Investment consulting fees	33.0	60.0	7.0	39.0	52.8	8.1
Legal fees	10.3	84.7	5.0	20.7	66.7	12.6
Trustee fees	29.4	66.6	4.0	47.2	43.2	9.6

Source: Profit Sharing/401(k) Council of America (PSCA).

<sup>a</sup>In some cases, plan record-keeping fees are charged as a percentage of assets.

Participants generally pay investment fees indirectly. The investment returns that participants receive reflect their share of the fund's assets after investment fees and other expenses have been subtracted. Investment fees are reported as a percentage of the fund's overall assets, also known as the expense ratio.

The 2005 survey of plan sponsors also found that participants bear a plan's record-keeping fees in about 50 percent of plans with 5,000 participants or more. Plan sponsors paid record-keeping fees in about 35 percent of these plans and share fees with participants in about 15 percent. The opposite is true for plans with fewer than 5,000 participants, where plan sponsors paid record-keeping fees in 58 percent of cases. However, many of the industry professionals whom we spoke with said plan participants bear a greater portion of these fees than they did in the past. According to these professionals, record-keeping fees have shifted to participants because companies changed the way they charge record-keeping fees and many plan sponsors wanted to reduce their share of plan fees. Originally, record-keeping fees were explicit fees billed to the plan sponsor. When the use of mutual funds in 401(k) plans started to grow, some funds were marketed to sponsors as having no record-keeping fees. In these cases, record keepers were compensated out of the investment funds' operating expenses for their services, such as maintaining individual account records for its retail investors and consolidating participant requests to

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buy or sell shares. Some sponsors may have been unaware that record-keeping fees were taken out of participant assets. Others were aware that the fees were passed on to participants.

Record-keeping fees may be charged as a percentage of assets, or based on the number of transactions or the number of participants in the plan. Some industry professionals told us that fees charged as a percentage of assets may not reflect actual costs to the service provider since the fees grow regardless of the level of service provided. The professionals said service providers may charge record-keeping fees to participants as a flat fee and as an asset-based fee in plans with low assets. An asset-based fee would not generate enough revenue to cover record-keeping fees in these plans, so a flat fee is added. As plan assets grow, the revenue generated by asset-based fees eventually covers plan record-keeping fees, and the flat fee may be dropped. Other industry professionals said record-keeping fees may vary if they are offered by insurance companies or banks that can use fee structures unique to their industry.

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## Required Disclosures Provide Limited Fee Information to Assist Participants in Comparing Investment Options

The fee information that ERISA requires 401(k) plan sponsors to disclose is limited and does not provide participants with an easy comparison of 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. Additional fee disclosures are required for certain—but not all—plans in which participants direct their investments. These disclosures are provided to participants in a piecemeal fashion and do not provide a simple way for participants to compare plan investment options and their fees.

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## Disclosures Provide Limited Information on Fees to Participants in a Piecemeal Way

ERISA requires that plan sponsors provide all participants with a summary plan description, account statements, and the summary annual report, but these documents are not required to disclose information on fees borne by individual participants. Table 2 provides an overview of each of these disclosure documents, and the type of fee information that they may contain.

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**Table 2: Required Disclosure Documents to All Participants**

<b>Disclosure document</b>	<b>Document purpose</b>	<b>Information on fees</b>
Summary plan description	To explain to participants how the plan operates.	May contain information on how various fees—such as investment, record-keeping, and loan fees are charged to participants—but not required by ERISA to do so.
Account statement	To show the account balance due to a participant.	Typically identifies fees, such as for loans, that are directly attributable to an account during a specific period. Also, may show investment and record-keeping fees, but not required by ERISA to do so.
Summary annual report	To disclose the financial condition of the plan to participants.	Contains total plan costs incurred by plan participants during the year.

Source: GAO analysis.

These required documents apply to all 401(k) plans, including plans in which participants have no control over investment decisions. 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, among other information, a description of the investment risk and historical performance of each investment option available in the plan and any associated transaction fees for buying or selling shares in these options.<sup>13</sup> Upon request, 404(c) plans must also provide participants with, among other information, the expense ratio for each investment option. To meet certain 404(c) requirements, such plans distribute prospectuses or fund profiles. The prospectuses and fund profiles are not meant to be comprehensive for the entire 401(k) plan, but rather are relevant for individual investment options in the plan.

According to the most recent Form 5500 data, 54 percent of 401(k) plans—representing 64 percent of 401(k) participants—classify themselves as

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<sup>13</sup>ERISA Section 404(c) generally provides relief for plan fiduciaries of certain individual account plans, such as 401(k) plans, from liability for the results of investment decisions made by plan participants and beneficiaries, under conditions specified in 29 C.F.R. § 2550.404c-1.

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404(c).<sup>14</sup> However, the data also show that 87 percent of 401(k) plans—representing 92 percent of 401(k) participants—direct their 401(k) investments. These data suggest that some participant-directed plans are not 404(c) and, thus, not required to disclose to participants certain fee information such as the expense ratio of each investment option.

Plan sponsors may voluntarily provide participants with more information on fees than ERISA requires, according to plan practitioners. For example, plan sponsors that do not elect to be 404(c) often distribute prospectuses or fund profiles when employees become eligible for the plan, just as 404(c) sponsors do. Also, according to plan practitioners, plan sponsors are not required to provide record-keeping or other fee information in their account statements, although many do so. In addition, plan sponsors are not required to provide the investment fees for the investment options in the summary plan document, but they may provide this information as well. Still, absent requirements to do so, some plan sponsors may not identify all the fees participants pay.

Participants may not be aware of the different fees that they pay, yet are responsible for directing their investments within the plan. According to industry professionals, participants can be unaware that they pay any fees for their 401(k) investments and are particularly unaware of investment fees that are typically not quantified on account statements. In a nationwide survey, more than 80 percent of 401(k) participants report not knowing how much they pay in fees.<sup>15</sup> Some industry professionals said that making participants who direct their investments more aware of fees would help them make more informed investment decisions.

Information on fees is disclosed to participants in a piecemeal way. In order to get a more complete picture of fees, participants must collect various documents over time. As shown in table 3, disclosure documents with fee information are generally provided to participants at different times.

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<sup>14</sup>The actual percentage of plans that qualify under 404(c) is unclear because the information is self-reported.

<sup>15</sup>AARP Public Policy Institute, “Pension Participant Knowledge About Plan Fees,” *Data Digest* (November 2004).

**Table 3: Required Timing of Disclosure Documents with Fee Information**

Disclosure document	Timing requirement
Summary plan description	Within 90 days of being covered by the plan, then every 5 or 10 years depending on changes.
Account statement	Generally, within 30 days of a written request <sup>a</sup>
Summary annual report	Annually
Prospectus or fund profile <sup>b</sup>	Immediately following initial investment.

Source: GAO analysis.

<sup>a</sup>The Pension Protection Act of 2006 requires quarterly account statements beginning in 2007.

<sup>b</sup>Required only for 404(c) plans and for securities regulated by the SEC.

Some documents that contain fee information are provided to participants automatically, whereas others, such as prospectuses or fund profiles, may require that participants seek them out. According to industry professionals, participants may not know to seek such documents out.

## Participants Cannot Easily Compare Investment Options Based on Fee Information Provided

ERISA does not require that plan sponsors provide participants who are responsible for directing their investments with fee information that could assist them in comparing the plan's investment options. To identify the fee information for comparing investment options, participants must sift through multiple documents that are not always disclosed to them automatically. For example, to piece together certain fees associated with a plan's investment options, a participant often must collect multiple prospectuses or fund profiles. Furthermore, because ERISA does not require that these documents be provided automatically to all participants, some participants may need to request them but may not know to do so. According to industry professionals, some participants may be able to make comparisons across investment options by piecing together the fees that they pay, but doing so requires an awareness of fees that most participants do not have. Assessing fees across investment options can be difficult for participants because the data are typically not presented in a single document which facilitates comparison.

Participants can use fees along with other information, such as risk and historical performance, to compare different investment options. In some cases, differences in fees across products can be explained by their investment focus or other features. For example, mutual funds with shares in international stock generally charge higher fees than mutual funds with shares in domestic stock because international funds generally incur

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additional investment management costs. Higher costs can also arise if an investment option has additional features. For example, a provider may charge an additional fee to include certain benefit features, such as providing the participant with an option to convert a 401(k) account balance into a retirement annuity. Industry associations have considered different ways to present comparative information about a plan's investment options to participants in a single document, but the industry does not have a standard way of doing so. These associations have generally suggested annually providing key information—such as the investment objective, fees, and other key features—associated with each plan's investment options in a table to help participants compare among them.

Industry professionals suggested that comparing the expense ratio—a fund's operating fees as a percentage of its assets—across investment options is the most effective way to compare options' fees. The expense ratio can be used to compare investment options because it includes investment fees that account for most of the fees borne by participants and is generally the only fee measure that varies by option. Fund options with relatively high fees, such as actively managed funds, tend to have larger expense ratios than funds which are not actively managed. Also, fund options that are only available to institutional investors tend to have lower expense ratios than other types of funds.

Most 401(k) investment options have expense ratios that can be compared, but this information is not always provided to participants. According to industry data, at least 69 percent of 401(k) assets are invested in options, such as mutual funds, that are generally required to present the expense ratio in a prospectus.<sup>16</sup> Participants who do not belong to 404(c) plans are not required to receive prospectuses and therefore may not receive the expense ratio information. In addition, investment options besides mutual funds, such as guaranteed annuity contracts, may not be required to produce prospectuses that include expense ratios, but according to industry professionals, such options have expense ratio equivalents that investment industry professionals can identify. However, participants who do not receive this information cannot compare the investment options' expense ratios.

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<sup>16</sup>Mutual funds provide prospectuses. Other investment options, such as company stock, may not provide prospectuses.

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Because differences in fees can have large impacts on returns over time, industry professionals recommend considering expense ratios when making investment decisions. However, they point out that expense ratios should not be considered in isolation; rather, they should be considered in light of other important investment factors, such as risk and historical performance.

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## Labor Has Authority over 401(k) Plan Fees and Certain Types of Business Arrangements, but Lacks Information for Effective Oversight

Labor has authority under ERISA to oversee 401(k) plan fees and certain types of business arrangements involving service providers, but lacks the information it needs to provide effective oversight. Labor collects information on fees from plan sponsors, investigates participants' complaints or referrals from other agencies on questionable 401(k) plan practices, and conducts outreach to educate plan sponsors about their responsibilities. However, the information reported to Labor does not identify all fees charged to 401(k) plans and therefore has limited use for effectively overseeing fees and identifying undisclosed business arrangements among consultants or other service providers. Certain business arrangements that are undisclosed may lead to participants paying higher fees for products or services that do not offer any additional value or benefit than other lower cost alternatives. Labor has several initiatives underway to improve the information it has on fees and the various business arrangements among service providers.

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## Labor Collects Information on Fees, Investigates Complaints and Referrals, and Conducts Outreach to Educate Plan Sponsors

Under ERISA, Labor is responsible for enforcing the requirements that plan sponsors (1) ensure that fees paid with plan assets are reasonable and for necessary services, (2) diversify the plan's investments or provide a broad range of investment choices for participants, and (3) report information known on certain business arrangements involving service providers. Labor does this in a number of ways, including collecting information on fees from plan sponsors, investigating participants' complaints or referrals from other agencies on questionable 401(k) plan practices, and conducting outreach to educate plan sponsors about their responsibilities.

## Information on Fees

Labor collects information on fees charged to 401(k) plans primarily through the Form 5500. The form includes information on the plan's sponsor, the features of the plan, and the number of participants. The form also provides more specific information, such as plan assets, liabilities, insurance, and financial transactions. Filing this form satisfies the requirement for the plan administrator to file annual reports concerning, among other things, the financial condition and operation of plans. Labor



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uses this form as a tool to monitor and enforce plan sponsors' responsibilities under ERISA.<sup>17</sup> The reporting form is not routinely provided to participants, but ERISA requires that it be made available upon request.

Generally, information on 401(k) fees is reported on two sections of the Form 5500, Schedule A and Schedule C.<sup>18</sup> Schedule A is used to report fees and commissions paid to brokers and sales agents for selling insurance products. Schedule C includes information on the fees paid directly or indirectly to service providers for all other investment products. Schedule C also identifies service providers with fees in excess of \$5,000 by name.

## Investigations

Labor officials told us that complaints from plan participants provide the most effective leads on plan sponsors' violations of ERISA, but that Labor receives very few complaints related to excessive 401(k) plan fees. In fiscal year 2005, Labor received only 10 inquiries or complaints related to 401(k) fees. A Labor official told us that most plan participants likely do not understand much about plan fees and are thus unlikely to complain about them. In addition to responding to complaints, Labor also receives referrals from various entities, such as other federal agencies. For example, federal banking regulators like the Federal Reserve Board will review bank operations as part of their oversight and may uncover instances where a bank that provides services to a 401(k) plan is violating ERISA requirements. Several federal banking regulators have a written agreement to refer such cases to Labor, but Labor receives fewer than 100 referrals per year from these and other entities, such as state insurance and securities agencies. A Labor official told us that only one of the referrals that the agency has closed over the past 5 years was directly related to fees.<sup>19</sup>

Labor uses the Form 5500 in its investigations, but according to agency officials, this effort does not find many fee violations because it is difficult to identify unreasonable fees. Officials stated that they conduct few investigations based solely on the 401(k) fee information provided on Form 5500 but may review the fees charged to the plan as a part of

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<sup>17</sup>29 U.S.C. § 1023.

<sup>18</sup>In addition to Schedule A and C, Labor also uses Schedules H and I to identify fee issues.

<sup>19</sup>Since fiscal year 2004, Labor has closed about 35 additional investigations each year that were referred from federal and state agencies. These referrals involved some sort of fiduciary breach and may have involved 401(k) plans.

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investigations into other problems, such as not depositing participants' contributions into their accounts in a timely manner. In addition, Labor may audit the Form 5500 to ensure that appropriate fees are disclosed.

Labor officials told us that it is difficult to discern whether a fee is reasonable or not on its face, and therefore, investigators rarely initiate an investigation into a fee's reasonableness. Plan fees can vary widely based on the types of services offered, and a "boutique" plan may have high fees but offer many services that a plan sponsor has determined are in the interest of the plan's participants. In the rare instance that a fee appears egregious, Labor will generally enlist the services of a "fee expert" to make that determination, because according to one official, Labor is unable to do so itself. A fee expert will conduct a benchmarking study or request estimates from other service providers to get a sense of the market rate for certain services.

Labor's most recent in-depth review of fees identified some plans with high fees but determined that they were not unreasonable or in violation of ERISA. Labor last undertook a comprehensive review of 401(k) fees in 1997, in response to media, industry, and government concern that participants were potentially being charged excessive fees. According to a Labor official, 50 401(k) plans were investigated to analyze plans' compliance with certain ERISA requirements related to fees, such as ensuring that fees charged to the plan are reasonable.<sup>20</sup> The plans were selected based on various factors including anecdotal evidence of high fees and a listing in an industry journal of plans that had recently contracted with service providers. Labor found that the plan sponsors had complied with these ERISA requirements. In some cases, Labor did determine that participants were paying high fees. It referred these cases—which included insurance products and international equity funds—to a fee expert from academia for further analysis to determine if the fees were unreasonably high. The expert determined that the fees were high, but not unreasonable. Labor uncovered some violations unrelated to fees and notified the plans of needed corrective actions.

In fiscal year 2006, seven of Labor's regional offices had ongoing enforcement projects related to fees, but none were exclusive to 401(k) plans. We spoke with four offices about their specific projects, the reasons

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<sup>20</sup>Labor also selected 10 403(b) plans, which are similar to 401(k) plans but offered only to employees of public schools and certain nonprofit organizations.

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for their initiation, and their findings to date. According to agency officials, most of the investigations under these projects were initiated due to allegations related to defined benefit plans. The projects focused on specific areas, such as bank trust department investigations, settlor fees, or intermediary investment fees and practices.<sup>21</sup>

## Outreach

Labor has launched a nationwide campaign to improve workers' health and retirement security by educating employers and service providers about their fiduciary responsibilities under ERISA.<sup>22</sup> Its fiduciary education program includes nationwide educational seminars with fees among the topics covered. Labor's campaign also includes several educational publications on topics such as understanding fees and selecting service providers. For example, one of the publications, *Understanding Retirement Plan Fees and Expenses*, is designed to help plan sponsors better understand and evaluate their plans' fees and expenses.<sup>23</sup> Another, *A Look at 401(k) Plan Fees for Employees*, highlights the most common fees that may be paid by plans and is geared toward plan participants.

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## Limited Information on Fees Paid by Plans Hinders Labor's Ability to Effectively Oversee Fees

The information reported to Labor on the Form 5500 has limited use for effectively overseeing fees paid by 401(k) plans because it does not explicitly list all of the fees paid from plan assets. For example, plan sponsors are not required to report mutual fund investment fees to Labor, even though they receive this information for each of the mutual funds they offer in the 401(k) plan in the form of a prospectus. In addition to disclosing this information to sponsors of 401(k) plans, mutual fund companies are required to file this information with the SEC, which

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<sup>21</sup>The goal of the bank trust department investigations project is to identify and investigate plans sponsored by banking institutions with a potential for fiduciary breaches and self dealing. Investigations in the settlor fee project examine the extent to which plans pay certain expenses that improperly confer a benefit on the plan sponsor. In some instances, the fees on their face may appear to be reasonable expenses, but should have been paid by the plan sponsor, rather than the plan. The main objective of the intermediary investment fees and practices project is to identify and correct violations stemming from abuses in fee arrangements, including hidden fees, excessive fees, and 12b-1 fees.

<sup>22</sup>Labor's fiduciary education program is intended to provide employers and plan officials with an understanding of the law and their responsibilities and focuses on steps for avoiding the most common problems Labor encounters in its enforcement activities. Labor's educational seminars help plan sponsors understand rules and meet their responsibilities to plan participants. Seminars are also targeted to small businesses that are considering starting a pension plan.

<sup>23</sup>For this and other publications related to 401(k) fees, see [www.dol.gov/ebsa](http://www.dol.gov/ebsa).

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regulates mutual funds.<sup>24</sup> While prospectuses are provided to SEC on a fund-by-fund basis, neither SEC nor Labor have readily available information to be able to link individual fund information to the various 401(k) plans to which the funds may be offered as investment options.<sup>25</sup> Furthermore, prospectuses provide fees as an expense ratio, which is deducted from plan assets when investment returns are calculated, and as such are not explicitly stated.<sup>26</sup> Without information on all of the fees charged directly or indirectly to 401(k) plans, Labor is limited in its ability to identify fees that may be questionable.

Industry experts told us that additional information could be reported on the Form 5500 to give Labor a more precise idea of the cost of administering a defined contribution plan and 401(k) plan fees. The ERISA Advisory Council Working Group reported that the Form 5500, as currently structured, does not reflect the way that the defined contribution plan fee structure works, because only those 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; they are deducted from investment returns and not reported to plan sponsors or on the Form 5500. The Advisory Council concluded that Form 5500s filed by defined contribution plans are of little use to policy makers, government enforcement personnel, plan sponsors, and participants in terms of understanding the cost of a plan. The Advisory Council recommended that Labor modify the Form 5500 and the accompanying schedules so that all fees incurred either directly or indirectly by these plans can be reported or estimated. This information then could be used to compare fees for research or regulatory purposes.

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<sup>24</sup>For investors outside of a 401(k) plan, the SEC requires the mutual fund to provide the prospectus directly to participants. However, in a 401(k) plan, the SEC requires the mutual fund to provide the prospectus to the plan sponsor. Sponsors of 404(c) plans are required to provide participants with a prospectus only upon request.

<sup>25</sup>Mutual fund prospectuses are filed with the SEC and are available to the public from SEC's Electronic Data Gathering, Analysis, and Retrieval system. The filings are not exclusive to those mutual funds offered as part of a 401(k) plan. Plan sponsors are not required to include prospectus fee disclosures with their Form 5500 filings. Further, it is not an agency practice for SEC to provide prospectus information to Labor, nor would such a practice benefit Labor unless the information was then consolidated with the corresponding Form 5500 filings for plans that offered the mutual fund.

<sup>26</sup>Further, under generally accepted accounting principles, the fees paid for mutual fund services are combined with a fund's gains and losses and reflected only, and indirectly, in the income section in a plan's Statement of Income and Expenses.

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## Labor and Plan Sponsors Lack Information on the Various Business Arrangements among Service Providers

Many opportunities exist for business arrangements to go undisclosed, given the various parties involved in today's 401(k) arena. Problems may occur when pension consultants or other companies providing services to a plan also receive compensation from other service providers. Without disclosing these arrangements, service providers may be steering plan sponsors toward investment products or services that may not be in the best interest of participants. In addition, plan sponsors, being unaware, are often unable to report information about these arrangements to Labor on Form 5500 Schedule C.

SEC recently identified certain undisclosed arrangements in the business practices of pension consultants that the agency referred to as conflicts of interest. Plan sponsors pay pension consultants to give them advice on matters such as selecting investment options for the plan and monitoring their performance and selecting other service providers, such as custodians, administrators, and broker-dealers. The 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.<sup>27</sup> For example, the report revealed that more than half of the pension consultants examined had compensation arrangements with brokers who sell mutual funds. The report highlighted concerns that these arrangements may provide incentives for pension consultants to recommend certain mutual funds to a 401(k) plan sponsor and create conflicts of interest that are not adequately disclosed to plan sponsors. Plan sponsors may not be aware of these arrangements and thus could select mutual funds recommended by the pension consultant over lower-cost alternatives. As a result, participants may have more limited investment options and may pay higher fees for these options than they otherwise would.

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. For example, a mutual fund normally provides record-keeping services for its retail investors, i.e., those who invest outside of a 401(k) plan. The same mutual fund, when

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<sup>27</sup>Office of Compliance Inspections and Examinations, *Staff Report Concerning Examinations of Select Pension Consultants* (U.S. Securities and Exchange Commission: May 16, 2005).

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associated with a plan, might compensate the plan's record keeper for performing the services that it would otherwise perform, such as maintaining individual participants' account records and consolidating their requests to buy or sell shares.<sup>28</sup>

The problem with hidden fees is not how much is being paid to the service provider, but with knowing what entity is receiving the compensation and whether or not the compensation fairly represents the value of the service being rendered. Labor's position is that plan sponsors must know about these fees in order to fulfill their fiduciary responsibilities. However, if the plan sponsors do not know that a third party is receiving these fees, they cannot monitor them, evaluate the worthiness of the compensation in view of services rendered, and take action as needed.

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## Labor Has New Initiatives to Improve Information on Fees

Labor officials told us about three initiatives currently underway to improve the disclosure of fee information by plan sponsors to participants and to avoid conflicts of interest. For one initiative, Labor is considering the development of a proposed 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 define the critical information on fees that plan sponsors should disclose to participants and the best way to do so. They are deliberating on what fee information should be provided to participants and in what format to enable participants to easily compare the fees across the plan's various investment options.

The second initiative proposes changes to the Form 5500 Schedule A and instructions to improve the disclosure of insurance fees and commissions and identify insurers who fail to supply information to plan sponsors. According to a 2004 ERISA Advisory Council Report,<sup>29</sup> many employers have difficulty obtaining timely Schedule A information from insurers. Labor proposes to add a checkbox to the form to permit plan sponsors to identify situations in which the insurance company has failed to provide Schedule A information. The form would also have space to indicate the type of information that was not provided. Because plan sponsors must submit a separate Schedule A for each insurance contract, Labor would be

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<sup>28</sup>These fees are known as subtransfer agent fees.

<sup>29</sup>*Final Report of the 2004 ERISA Advisory Council Working Group, Health and Welfare Form 5500 Requirements* (Nov. 10, 2004).

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able to identify which insurance companies are failing to satisfy their disclosure obligations under ERISA and its regulations.<sup>30</sup>

The second initiative also proposes changes requiring plan sponsors to report additional information on fees on Schedule C of Form 5500. Consistent with recommendations made by the ERISA Advisory Council Working Groups and GAO, Labor issued a proposed rule on July 21, 2006, to revise the Schedule C and accompanying instructions to clarify that the plan sponsor must report any direct and indirect compensation (i.e., money or anything else of value) it pays to a service provider during the plan year. Also, a new section would be added requiring that the source and nature of compensation in excess of \$1,000 received from parties other than the plan or the plan sponsor, such as record-keepers, be disclosed for certain key service providers, including, among others, investment managers, consultants, brokers, and trustees as well as all other fiduciaries. Labor officials told us that the revision aims to improve the information plan sponsors receive from service providers. The officials acknowledge, however, that this requirement may be difficult for plan sponsors to fulfill without an explicit requirement in ERISA for service providers to give plan sponsors information on the fees they pay to other providers.

The third initiative involves amending Labor's regulations under section 408(b)(2) of ERISA to define the information plan sponsors need in deciding whether to select or retain a service provider. According to Labor, plan sponsors need information to assess the reasonableness of the fees being paid by the plan for services rendered and to assess potential conflicts of interest that might affect the objectivity with which the service provider provides its services to the plan. The proposed change to the regulation is intended to make clear what plan sponsors need to know and, accordingly, what service providers need to provide to plan sponsors.

In addition to these three initiatives, Labor has a model fee disclosure worksheet available on its Web site. The worksheet was developed to help plan sponsors analyze and compare fees during their negotiations with service providers. Labor worked with several industry groups to develop this worksheet as a result of the problems it identified during its 1997 investigations on 401(k) fees. Labor officials told us that this worksheet or a similar tool could be used to facilitate plan sponsors attainment and

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<sup>30</sup>29 U.S.C. § 1023(a)(2).

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analysis of fee information and that plan service providers could also use the worksheet to disclose their fee arrangements when soliciting potential clients.

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## Conclusions

As American workers take increasing responsibility for the adequacy of their retirement savings through 401(k) plans, they need to be more aware of the fees that they pay. ERISA does not explicitly require plan sponsors to disclose comprehensive information on fees to participants, yet even small fees can significantly affect retirement savings over the course of a career. Information about investment options' historical performance is useful, but alone does not provide participants with enough information for making informed investment decisions. Giving participants key information on fees for each of the plan's investment options in a simple format—including fees, historical performance, and risk—will help participants make informed investment decisions within their 401(k) plan. In choosing between investment options with similar performance and risk profiles but different fee structures, the additional provision of expense ratio data may help participants build their retirement savings over time by avoiding investments with relatively high fees.

Amending ERISA and updating regulations to better reflect the impact of fees and undisclosed business arrangements among service providers will help Labor provide more effective oversight of 401(k) plan fees. Without such changes, Labor will continue to lack comprehensive information on all fees being charged directly or indirectly to 401(k) plans. In addition, some conflicts of interest that affect the fees that participants pay may continue to go unnoticed because service providers are not required to inform plan sponsors of the compensation they receive from other service providers. As a result, Labor may not be able to identify instances in which service providers might be steering plan sponsors to overpriced investment options or services that are not in the best interest of plan participants. Further, requiring plan sponsors to report more complete information to Labor on fees—those paid out of plan assets or 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.



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## Matters for Congressional Consideration

To ensure that participants have a tool to make informed comparisons and decisions among plan investment options, Congress should consider amending ERISA to require all sponsors of participant-directed plans to disclose fee information of 401(k) investment options to participants in a way that facilitates comparison among the options. This information could be provided via expense ratios and be communicated annually in a single document alongside other key information about the investment options such as historical performance and risk. Providing such a disclosure to participants who are responsible for directing their 401(k) investments would ensure that they have another important tool to make informed comparisons and investment decisions among the plan's options.

To allow plan sponsors, and ultimately Labor, to provide better oversight of fees and certain business arrangements among service providers, Congress should consider amending ERISA to explicitly require that 401(k) service providers disclose to plan sponsors the compensation that providers receive from other service providers.

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## Recommendation for Executive Action

To better enable the agency to effectively oversee 401(k) plan fees, the Secretary of Labor should require plan sponsors to report 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.

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## Agency Comments

We provided a draft of this report to Labor and SEC. Labor provided written comments, which appear in appendix II. Labor's comments generally agree with the findings and conclusions of our report. Specifically, Labor stated that it will give careful consideration to GAO's recommendation that plans be required to provide a summary of all fees that are paid out of plan assets or by participants. Labor and SEC also provided technical comments on the draft, which we incorporated as appropriate.

Labor described a number of details related to its ongoing regulatory initiatives and outreach activities, many of which we also cited in the section of our report on Labor's authority and oversight. In its written comments, Labor also suggested an additional technical change on legal fees for plan design, which we have made to the final report.

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Unless you publicly announce its contents earlier, we plan no further distribution until 30 days after the date of this report. At that time, we will send copies of this report to the Secretary of Labor, the Chairman of the SEC; appropriate congressional committees; and other interested parties. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-7215 or [bovbjergb@gao.gov](mailto:bovbjergb@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who have made major contributions to this report are listed in appendix III.

Sincerely,

A handwritten signature in black ink that reads "Barbara D. Bovbjerg". The signature is written in a cursive style with a large, stylized initial "B".

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

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# Appendix I: Scope and Methodology

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To identify the major fees associated with 401(k) plans and how they are charged to plan sponsors and plan participants, we interviewed officials from Labor, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the Securities and Exchange Commission (SEC), and the Treasury Department's Office of the Comptroller of the Currency (OCC); met with service providers and other industry professionals; and collected information about the range of fees and how they are charged to plan sponsors and participants. We also reviewed several major 2005 industry surveys of 401(k) sponsors including surveys by HR Investment Consultants, the Profit Sharing and 401(k) Council of America (PSCA), and Hewitt Associates. Since the survey response rates are low, the data may not be generalizable. To assess reliability of the survey data, we contacted the authors of each survey and collected information on the methodology that was used to complete it.

- The results of HR Investment Consultants' survey are based on responses from 125 vendors that service 401(k) plans. This response represents about 85 percent of the assets invested in 401(k) plans. Company officials said they survey vendors because they are generally more knowledgeable than employers about plan fees. The survey was e-mailed to respondents as an attachment in 2004 and the results were updated in 2005. The authors were not able to provide a response rate, but said the survey was completed by most respondents. HR Investment Consultants provides a range of services to employers offering participant-directed retirement plans.
- PSCA's survey results are based on responses from 1,106 plan sponsors that have profit-sharing plans, 401(k) plans, or a combination of both and represent 1 to 5,000-plus employees. The survey was mailed or faxed to respondents and conducted from March 2006 to May 2006. The survey provides a snapshot as of the end of 2005. The survey response rate was 21 percent. PSCA officials were able to provide us with data that excluded profit-sharing plans only. PSCA is a national, nonprofit association of 1,200 companies and their 6 million plan participants. According to PSCA, it represents the interests of its members to federal policy makers and offers assistance with profit sharing and 401(k) plan design, administration, investment, compliance, and communication.
- Hewitt Associates' survey results are based on responses from 458 employers with 1,000 employees or more. Nineteen percent of the respondents represented Fortune 500 companies. The survey

was conducted from mid-March through April 2005. The survey and a link to a Web site were e-mailed to respondents whose email addresses were available so they could complete the survey on the Web or on paper. The other surveys were mailed with a stamped and addressed envelope. The survey had a 9 percent response rate. Hewitt Associates is a human resource outsourcing and consulting firm.

To assess how fees are disclosed to plan participants, we reviewed relevant laws and regulations, spoke with agency and industry officials, and reviewed sample disclosure documents. To understand requirements to disclose information about fees to participants, we reviewed ERISA and relevant regulation sections such as 404(c) and spoke with agency officials described above.

To identify the content and frequency of fee-related disclosures typically made to 401(k) plan participants, we spoke with plan practitioners and reviewed documents including sample disclosure documents. Specifically, we interviewed an array of service providers that serve plans of varying sizes including members of the American Bankers Association, American Benefits Council, American Council of Life Insurers, American Society of Pension Professionals & Actuaries, Securities Industry Association, Society of Professional Administrators and Record Keepers, as well as several plan consultants. We also interviewed officials from three plan sponsors. However, because we could not readily obtain a representative sample of service providers or plan sponsors, the information obtained does not represent the views of all service providers or plan sponsors. In addition, we reviewed a limited number of sample disclosure documents made to participants. Because the documents do not reflect a representative sample, we supplemented the information with Labor documents, including those from the 2004 ERISA Advisory Council's Working Group on Fee and Related Disclosures to Participants, to determine the type of disclosures typically made to participants.

To understand participants' awareness of fees and related disclosures, we spoke with the American Association of Retired Persons (AARP) in addition to the agency and other industry professionals listed above. We also reviewed AARP's nationwide survey of plan participants regarding plan fees and assessed its methodology. The survey reached plan participants aged 25 or older during November and December 2003. The total sample of over 1,200 respondents was stratified by age and geographic region and then weighted by age, region, and gender to create a representative sample of the total population.

To assess Labor's role in overseeing plan fees and certain types of business arrangements, we reviewed Labor's and other agencies' legal and regulatory authority and Labor's procedures for assuring that plans meet overall legal requirements. We reviewed the information required to be reported on the Form 5500, and several reports produced by federal agencies, trade associations, participant groups, and industry experts, regarding retirement plan fees and business arrangements among service providers. In addition to interviewing Labor officials in the national office about their enforcement and outreach efforts, we also interviewed officials from Labor's regional offices located in Atlanta, Georgia; Philadelphia, Pennsylvania; San Francisco, California; and Chicago, Illinois about their ongoing enforcement projects related to fees. We spoke with officials from the four offices about their specific projects, the reasons for their initiation, and the findings to date. Finally, we inquired about Labor's past initiative specific to 401(k) fees and reviewed Labor's current initiatives related to 401(k) plans.

# Appendix II: Comments from the Department of Labor

**U.S. Department of Labor**

Assistant Secretary for  
Employee Benefits Security Administration  
Washington, D.C. 20210



November 1, 2006

Barbara D. Bovbjerg  
Director, Education, Workforce, and  
Income Security Issues  
United States Government Accountability Office  
Washington, DC 20548

Dear Ms. Bovbjerg:

Thank you for providing the Department of Labor (Department) the opportunity to offer remarks concerning the Government Accountability Office's (GAO) draft report entitled "Private Pensions: Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees" (GAO-07-21). This letter provides the Department's response to the recommendations contained in the draft report.

The GAO report concluded that as "American workers take increasing responsibility for the adequacy of their retirement savings through 401(k) plans, they need to be more aware of the fees that they pay." To ensure that participants have the necessary information and tools to make informed decisions concerning the investment options available in their 401(k) plans, GAO recommends that action be taken by Congress and by the Department. Specifically, the report suggests that Congress consider amending the Employee Retirement Income Security Act of 1974 (ERISA) "to require all sponsors of participant-directed plans to disclose fee information of 401(k) investment options to participants in a way that facilitates comparison among the options[,] for example, by providing expense ratios annually in a single document. The report also requests that Congress consider amending ERISA "to explicitly require 401(k) service providers to disclose to plan sponsors the compensation they receive from other service providers."

In addition to these recommendations to Congress, the GAO report recommends that the Secretary of Labor "require plan sponsors to report a summary of all fees that are paid out of plan assets or directly by participants." The GAO believes that this reporting requirement will better enable the Department to oversee 401(k) plan fees.

As recognized in your report, the Department currently is pursuing a variety of regulatory initiatives focused on improving the transparency of fee and expense information at both the plan fiduciary and the participant level. As discussed below, two of these initiatives focus on the information that should be disclosed to plan

sponsors and fiduciaries. The other initiative involves a review of the information required to be disclosed to employees in participant-directed individual account plans.

With regard to the disclosure of fee-related information to plan sponsors and fiduciaries, the Department is considering an amendment to its regulation under section 408(b)(2) of ERISA.<sup>1</sup> The amendment would help ensure that, at the time of selection or renewal of a service provider, plan fiduciaries have sufficient information concerning the compensation to be paid to the service provider and the revenue sharing arrangements of the service provider to be able to assess both the reasonableness of the compensation being paid by the plan for the specific services and potential conflicts of interest that may exist on the part of the service provider. The Department believes that this information will assist a plan fiduciary in discharging his or her responsibilities consistent with ERISA.

In addition to taking steps to ensure that plan fiduciaries obtain the information that they need when entering into or renewing service arrangements, the Department is considering revisions to the Form 5500 Annual Report that will complement the information obtained by plan fiduciaries as part of the service provider selection or renewal process. In this regard, the Department published, for public comment, a number of changes to the Form 5500, including changes that would expand the information required to be reported on the Schedule C (Service Provider Information).<sup>2</sup> Among other things, the proposed changes to the Schedule C are intended to assist plan officials in assessing the reasonableness of compensation paid for services and potential conflicts of interest that might affect those services. The Department currently is in the process of reviewing public comments on the proposed Schedule C and other changes to the Form 5500.

The Department also is reviewing what regulatory steps might be taken to improve the disclosure of plan fee and expense information to plan participants and beneficiaries in the context of participant-directed individual account plans. As noted in your report, plan and investment-related expenses are often charged against the account of the individual participant. Accordingly, understanding what and how expenses affect participant accounts and retirement savings is of critical importance to plan participants and beneficiaries. This initiative is intended to explore what steps might be taken to ensure that participants have the information they need to make informed decisions about their plan and available investment options, 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. As part of this review, the Department will give careful consideration to GAO's recommendation that plans be

<sup>1</sup> Section 408(b)(2) provides a statutory exemption from ERISA's prohibited transaction rules for qualifying service contracts or arrangements between plans and service providers, which are "parties in interest" to plans under ERISA.

<sup>2</sup> See 71 Fed. Reg. 41616 (July 21, 2006).

required to provide a summary of all fees that are paid out of plan assets or directly by participants.

As also recognized in your report, the Department has long been committed to assisting plan sponsors, plan fiduciaries, and plan participants and beneficiaries in understanding the importance of plan fees and expenses and the effect of those fees and expenses on retirement savings. The Department has developed, and currently makes available on its website, a variety of educational materials specifically designed to help plan sponsors, fiduciaries, participants, and others understand the complexities of the various fee and compensation arrangements involved in today's pension benefit plan programs and, in particular, 401(k) plans. The Department's brochure entitled "A Look at 401(k) Plan Fees for Employees" is targeted to participants and beneficiaries of 401(k) plans that are responsible for directing their own investments. For employers and other plan fiduciaries, the Department provides the following materials: "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 to these various publications, the Department currently is conducting a series of educational programs, relating to both pension and health plans, intended to educate plan sponsors and fiduciaries about their obligations and duties under the law. A critical component of these programs is providing an understanding of the importance of selecting service providers for the plan and the role of fee and compensation considerations in that selection process. In this regard, the Department has conducted 17 fiduciary education programs, entitled *Getting it Right - Understanding Your Fiduciary Responsibilities*, in different cities throughout the United States. Similarly, the Department has conducted more than 40 health benefits education seminars, covering nearly every state, that also focus on the fiduciary considerations attendant to the selection of service providers. The Department will continue providing seminars in additional locations under each Program.

The Department also has provided guidance regarding certain fees that may not be charged in any amount to plans. In an advisory opinion and a Field Assistance Bulletin (AO 2001-01A and FAB 2002-02), the Department has distinguished "settlor" activities, which relate to the establishment, design, and termination of plans, from plan management activities, which are fiduciary or administrative in nature. The Department maintains that the plan sponsor, rather than the plan, should bear the cost of settlor functions. In this regard, we note that on page 12 of the draft report, the reference to legal fees being charged to help with plan design should be deleted.

In addition to its outreach programs, the Department provides a model form on its website that is specifically designed to assist plan fiduciaries and service providers in exchanging complete disclosures concerning the costs involved in service arrangements. This "401(k) Plan Fee Disclosure Form" is the product of a coordinated



effort of the American Bankers Association, Investment Company Institute, and the American Council of Life Insurers. The Department, in connection with the regulatory initiatives described above, is exploring possible improvements to this tool, as well as other resources that may be useful for plan fiduciaries, participants and beneficiaries, and service providers in this context.

We appreciate having had the opportunity to review and comment on this draft report. Please do not hesitate to contact us if you have questions concerning this response or if we can be of further assistance.

Sincerely,



Bradford P. Campbell  
Acting Assistant Secretary

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# Appendix III: GAO Contact and Staff Acknowledgments

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## GAO Contact

Barbara D. Bovbjerg (202) 512-7215 or [bovbjergb@gao.gov](mailto:bovbjergb@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Tamara Cross, Assistant Director, Daniel Alspaugh, Monika Gomez, Joel Green, Susan Pachikara, Dayna Shah, Roger Thomas, Rachael Valliere, and Walter Vance made important contributions to this report.

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