DEFINED CONTRIBUTION PLAN PERFORMANCE AND FEE DISCLOSURE ISSUES

Recently, much attention has been focused on the adequacy of disclosure regarding 401(k) plan fees. As an association committed to improving retirement security, the American Benefits Council welcomes the attention and the opportunity to discuss all that is positive about the private retirement system. To the extent that there are discrete problems in the fee area, we are very committed to finding constructive solutions to those problems through enhanced disclosure that facilitates active and healthy price competition. This document is intended to provide helpful background with respect to the fee issues, including discussions, for example, of what the fees pay for, who pays them, and who receives them.

One critical point, however, needs to be emphasized upfront. Any specific fee can only be effectively evaluated in the context of the quality of the service or product that is being paid for. For example, some actively managed investment options may logically have higher than average expenses, but it is the net performance of the option that is critical to retirement plan sponsors and participants, not the fee component in isolation. We must avoid studying fees in a vacuum: fees are very important, but they are only one component of performance. Our objective should be excellent performance and service at a fair price.

What Services and Products Are Fees Paying For?

In the past 25 years, there has been enormous progress in the development of services and products available to defined contribution plans ("DC plans"). For example, 25 years ago, participants generally were not permitted to invest their assets in accordance with their own objectives; the plan fiduciary generally invested all plan assets together. Plan assets generally were valued once per quarter – or even once per year – so that employees' accounts were generally not valued at the current market value. Today, most DC plans value plan investments on a daily basis, and permit participants to make investment exchanges frequently (often on a daily basis) to achieve their own objectives. In addition, the legal environment for DC plans was far simpler 25 years ago, with far fewer legal requirements and design options. Also, defined benefit plans played a much bigger role 25 years ago, leaving far less need for DC plan distribution options that address a participant's risk of outliving his or her retirement savings.

The DC plan market has reacted to this continually changing environment with a wide array of services and products designed to address the varying needs of today's employers and employees. Naturally, each of these services and products has a cost.

Who Pays DC Plan Fees?

By law, the employer must pay certain fees, such as the cost of designing a plan. But there are a wide range of fees that may be paid by the plan, such as fees for investments (which generally constitute the vast majority of a plan's total fees), recordkeeping, trustee services, participant communications, investment advice or education, plan loans, compliance testing, and plan audits. Many employers voluntarily pay for certain expenses that could be charged to the plan, such as recordkeeping and administrative expenses. On the other hand, investment expenses, such as expenses of a particular mutual fund, are generally borne by the participant whose account is invested in the fund.

Many fees vary only slightly (if at all) based on the number of participants in a plan. Accordingly, on a per-participant basis, plan costs can be much higher for small plans than for large plans. On a similar point, many costs do not vary with the size of a participant's account, so plans with small accounts will generally pay much higher fees – on a percentage of assets basis – than plans with large accounts. These effects are a function of the nature of the services rendered: for example, generally the same participant communications regarding the plan have to be prepared without regard to whether a plan has 100 participants or 100,000 participants, and without regard to whether the average account size is $5,000 or $50,000.

Why Does One Service Provider Sometimes Receive Fees From Another Service Provider? Is This "Revenue Sharing"? Is This A Problem Area?

It is not uncommon, for example, for mutual funds to pay other plan service providers for services needed by the funds. For example, assume that participants of a plan invest some of their assets in Mutual Fund A. Mutual Fund A needs to ensure that, for example, (1) records are maintained regarding which participants have invested in the Fund, and (2) participants receive timely information with respect to the Fund and receive answers to any Fund-related questions they have. It would not be uncommon for Fund A to pay the plan's recordkeeper to perform these services.

Such "inter-service provider" fees arise because numerous service providers cooperate in providing a total service package to a plan. "Revenue sharing" is not a term of art, but it is often used to described these types of inter-service provider fees.

There is nothing inherently problematic regarding inter-service provider fees. For example, assume that a plan pays Service Provider A $100 for investment services and the plan pays Service Provider B $50 for recordkeeping services. Assume further that A pays B $10 to help A perform investment services. If $100 and $50 are fair prices, why does it matter whether A performs the investment services itself or contracts with B to perform some of the investment services? The only situation where that is a problem is where B is a plan fiduciary, and as such, B recommends to the plan that the plan hire A to perform the investment services knowing that A will in turn hire B to help.

We are not suggesting that disclosure of the inter-service provider fees is not important. On the contrary, we are very supportive of such disclosure. But the transaction itself does not raise separate issues except in the circumstances noted above.

Are Plan Fees Too High?

Competition among investment options and service providers is intense, which exerts enormous pressure on fee levels. For example, investment expenses are generally the largest plan expense. Effectively, these expenses are reviewed in the context of reviewing the performance of investment options. Plans routinely review such performance; a 2006 survey by the Profit Sharing/401(k) Council of America indicates that 62% of plans review plan investments at least quarterly and substantially all plans conduct such a review at least annually.

In fact, plan investment fees are much lower than fees outside the context of plans. For example, a 2006 study by the Investment Company Institute found that in 2005 the average asset-weighted expense ratio for 401(k) plans investing in stock mutual funds was .76%, compared to a .91% average for all stock mutual funds.

Is There More That Can Be Done With Respect To Fee Disclosure?

The retirement plan community very much wants to learn about any problems that exist today with respect to the adequacy of plan fee disclosure. If there are pockets of problems, we need to identify those problems and solve them. In fact, the American Benefits Council, in conjunction with a number of other trade associations, has been actively working with the Department of Labor on improving disclosure. Fee disclosure problems can undermine confidence in the retirement system, which can undermine retirement security. We are therefore committed to working with the government to making any needed improvements to the fee area. We believe that the best approach to the fee issue is through enhanced, simple, clear disclosures that enable plan sponsors and participants to understand and compare plan fees.