TESTIMONY OF ALLISON R. KLAUSNER

ON BEHALF OF

AMERICAN BENEFITS COUNCIL

BEFORE THE

HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS

FOR THE HEARING

ON THE

APPROPRIATENESS OF RETIREMENT PLAN FEES

TUESDAY, OCTOBER 30, 2007

Introduction.

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

I am here today on behalf of the American Benefits Council (the "Council"). The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans. Honeywell serves on the Council's Board of Directors and actively participates both directly and through the Council in public policy discussions regarding benefits issues confronting our country.

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

With the decline of the defined benefit plan system, 401(k) plans have become the primary retirement plan for millions of Americans. Accordingly, it is more important than ever for all of us to take appropriate steps to ensure that 401(k) plans provide those Americans with retirement security. The goal should be a 401(k) system that functions in a transparent manner and provides meaningful benefits at a fair price in terms of fees. At the same time, we all must bear in mind that unnecessary burdens and cost imposed on these plans will slow their growth and reduce participants' benefits, thus undermining the very purpose of the plans.

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

We Support Enhanced Disclosure And Reporting Requirements.

With respect to 401(k) plan fees, we believe that this Committee would be pleased by what the Council's member companies are doing. Our members – both plan sponsors and service providers – report to us that plan fiduciaries are taking extensive steps to ensure that fee levels are fair and reasonable for their participants.

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

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

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

Department of Labor and Government Accountability Office

With respect to fee disclosure, we commend the Department of Labor and the Government Accountability Office ("GAO"). The Department of Labor has been working on a three-part project to enhance transparency that is conceptually the same as the enhanced regime we are recommending. This three-part approach is very similar to the recommendations made by GAO. One part would require the type of disclosure by service providers to plan fiduciaries that I refer to above. A second part would require clear, meaningful disclosure to participants, also as I have discussed. And a third part would require plans to report fee information to the Department. We may have concerns regarding certain specific points with respect to the Department's proposals as they are issued, but conceptually we are in agreement with the general approach. We believe that the Department is addressing the key policy issues that have been raised regarding fee transparency, and we look forward to a constructive dialogue with the Department as its proposals move forward.

As described in its letter to GAO regarding plan fees, the Department of Labor has already taken a number of steps to improve awareness and understanding with respect to plan fees. The Department makes available on its website important materials designed to help participants and plan fiduciaries understand plan fees. These materials include "A Look at 401(k) Plan Fees for Employees", which is designed to assist participants in understanding plan fees and selecting investment options. For employers and other plan fiduciaries, the Department makes available "Understanding Retirement Plan Fees and Expenses", "Tips for Selecting and Monitoring Service Providers for Your Employee Benefit Plan", and "Selecting and Monitoring Pension Consultants – Tips for Plan Fiduciaries". In addition, the Department makes available a model form – called the "401(k) Plan Fee Disclosure Form" – that is designed to facilitate both the disclosure of plan fees by service providers to plan fiduciaries and the comparison of these fees. Finally, the Department conducts educational programs across the country that are designed to educate plan fiduciaries about their duties.

In short, we believe that the Department of Labor and GAO have been making, and continue to make, important contributions to improving the 401(k) plan system. We are also proud of our own efforts to improve fee disclosure. In addition to my testimony on behalf of the American Benefits Council as a witness at the Department of Labor's EBSA Advisory Council last month, the American Benefits Council, together with other trade organizations, has been working in a constructive manner with the Department to help it improve fee disclosure and transparency for years. In 2006, the American Benefits Council, together with a group of trade associations, submitted to the Department an extensive list of fee and expense data elements that plan sponsors can use to discuss fees effectively with their service providers. The associations were the American Benefits Council, the Investment Company Institute, the American Council of Life Insurers, the American Bankers Association, and the Securities Industry Association (now the Securities Industry and Financial Markets Association). In addition, these same organizations recently submitted joint recommendations to the Department in response to its Request for Information regarding fee disclosures to participants; the following organizations also joined in making these recommendations: the Committee on Investment of Employee Benefit Assets, The ERISA Industry Committee, the Profit Sharing/401k Council of America, the National Association of Manufacturers, the U.S. Chamber of Commerce, the Financial Services Roundtable, and the Society for Human Resource Management. We view disclosure enhancement as a critical part of our mission to strengthen the 401(k) plan system.

Addressing Concerns And Questions.

So far, we have been focusing on positive things that can be done to improve the 401(k) plan system. Now we would like to touch on certain concerns and answer some questions that have been raised.

Coordination Of Legislative And Regulatory Processes.

To reiterate, we support improvement to the rules regarding plan fee disclosure. Effective plan fee disclosure to participants will provide them with an opportunity to understand the available fund choices and select investments designed to help them achieve retirement security. Disclosure to plan fiduciaries equips fiduciaries with the information necessary to negotiate and shop for the services appropriate to support the sponsor's plan design. In addition, clarity with respect to both sets of rules can provide plan fiduciaries with a means of helping their participants without liability.

In the effort to improve the fee disclosure rules, we believe that it is very important that the legislative and regulatory processes be coordinated. For example, it would be very harmful for participants, plan sponsors, and providers for one set of rules to apply for a year or two, only to be supplanted by a different set of rules. The additional programming and data collection costs caused by such a scenario would be enormous, not to mention the resulting confusion among participants and plan fiduciaries. Such costs would, of necessity, generally be absorbed by plan participants and to some extent by plan sponsors. However, many plan sponsors could react to increased costs by reducing contributions and possibly even eliminating or failing to adopt plans; plan participants would simply receive smaller benefits, which would be unfortunate.

Accordingly, we urge both Congress and the Department to consider how best to coordinate their efforts to avoid adverse consequences.

We Must Not Undermine The Voluntary System.

The success of the 401(k) plan system is dependent on many things, including very notably the willingness of employers to offer these plans and the willingness of employees to participate in the plans. It is critical that any reform efforts not inadvertently undermine these key building blocks of our system. Clear, meaningful disclosure is needed; overly complicated and burdensome disclosures would only push employers and service providers away from the 401(k) plan system. In particular, burdensome rules would be yet another powerful disincentive for small employers to maintain plans. Participants need clear meaningful information that is relevant to their decision-making.

In addition, employee confidence is critical to their participation in the system. If the millions of employees participating in well-run efficient 401(k) plans hear only about 401(k) plan problems and do not hear about the strengths of the system and if they are given overly complex disclosures, their confidence will be eroded, their participation will decline, and their retirement security will be undermined.

We Must Not Inadvertently Increase Fees In The Effort To Reduce Them.

Every new requirement imposed on the 401(k) plan system has a cost. And generally it is participants who bear that cost. So it would be unfortunate and counterproductive if a plethora of new complicated rules are added in an effort to reduce costs, but the expense of administering those new rules actually ends up adding to those costs. The Department of Labor has explicitly raised this concern. In its letter to GAO regarding the GAO plan fee report, the Department noted that its own fee disclosure project must be designed "without imposing undue compliance costs, given that any such costs are likely to be charged against the individual accounts of participants and affect their retirement savings."

It is important to recognize a key point noted in the GAO report. In the course of numerous plan fee investigations conducted by the Department of Labor in the late 1990's, no ERISA violations were found with respect to 401(k) plan fees. Moreover, the Department of Labor receives enforcement referrals from various entities, such as federal and state agencies. The GAO report notes that "only one of the referrals that the [Department of Labor] has closed over the past 5 years was directly related to fees" (emphasis added). In the context of these facts – clear attention by the Department to fees but very little evidence of violations – imposing burdensome new rules and costs to be borne by participants would be even less justified and, in fact, would be counterintuitive.

This discussion leads logically to three points. First, any new requirement should not be added unless it provides material assistance to plan participants or fiduciaries. Second, any new requirement should be structured in such a way as not to add unnecessary costs or increase exposure to liability. Third, as new requirements are added, we must seize the opportunity to streamline the rules by revisiting the need for old requirements that may be out of date or rendered unnecessary by the new rules.

Disclosure To Plan Participants.

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

Honeywell believes strongly that any requirement regarding fee disclosure must be carefully crafted so that participants are not inadvertently led to think that selecting an investment option with the lowest fee is always the right choice. As we know, an investment option with low fees may generate higher or lower net investment returns relative to an investment choice with higher fees. Overly detailed or granular disclosure requirements may actually result in even higher fees for plan participants or more limited choices. In addition, excessive detail can serve to obscure key points. In contrast to the simple and clear disclosure which is appropriate for plan participants, plan fiduciaries need more detailed information to fulfill their fiduciary duties and make prudent choices on behalf of all of their participants.

Fees Can Only Be Evaluated In The Context Of The Services Provided.

We must avoid studying fees in a vacuum and we must avoid disclosure regimes that elevate fees over other issues of equal or greater importance to plans and their participants. Accordingly, any specific fee should be evaluated in the context of the quality of the service or product that is being paid for. For example, some actively managed investment funds may logically have higher than average expenses, but it is the net performance of the investment that is critical to retirement plan sponsors and participants, not the fee component in isolation.

Another example of this point is that increased fees generally reflect increased services. In the past several decades, there has been enormous progress in the development of services and products available to defined contribution plans ("DC plans") such as 401(k) plans. For example, many years ago, plan assets generally were valued once per quarter – or even once per year – so that employees' accounts were generally not valued at the current market value. Participants generally were not permitted to invest their assets in accordance with their own objectives; the plan fiduciary generally invested all plan assets together. Today, 401(k) plans generally value plan investments on a daily basis, and permit participants to control their accounts and make investment exchanges frequently (often on a daily basis) to achieve their own objectives. Other new services include, for example, internet access and voice response systems, on-line distribution and loan modeling, and on-line calculators for comparing deferral options.

In addition, the legal environment for DC plans used to be simpler, with far fewer legal requirements and design options. New legal requirements or options can require significant systems enhancements. For example, system modifications were needed to address catch-up contributions, automatic rollovers of distributions between $1,000 and $5,000, Roth 401(k) options, redemption fees and required holding periods with respect to plan investment choices, employer stock diversification requirements, default investment notices, automatic enrollment, and new benefit statement rules.

Also, as noted in our Introduction above, 401(k) plans have become the dominant retirement vehicle for millions of American workers. With this change has come the need to help participants adequately plan for their retirement. Service providers have responded by developing investment advice offerings, retirement planning and education, programs to increase employee participation in plans, and plan distribution options that address a participant's retirement income and asset needs.

Naturally, the new services and products and the needed systems modifications have a cost. In this regard, we also want to emphasize that the disclosure rules need to be flexible enough to take into account the ever evolving 401(k) plan service market.

On a related point, we see enhanced plan fee disclosure as another important step with respect to participant education. And we look forward to working with this Committee on further participant education initiatives.

Why Do Fee Levels Differ So Much Among Different Plans?

Different workforces and different plans need different services. Accordingly, the 401(k) plan market has attracted a variety of different service providers that have developed numerous service options for plans, often with different fee structures and different services available for separate fees. This has enabled plans to avoid paying for services that are unnecessary for their plan designs or otherwise not wanted or used, and increases the options available to plan sponsors seeking to find providers and services that meet the unique needs of their plans and their participants.

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

Who Pays DC Plan Fees?

By law, the employer must pay certain fees, such as the cost of designing a plan. But there are a wide range of fees that are permitted to be paid by the plan and its participants, such as fees for investments, recordkeeping, trustee services, participant communications, investment advice or education, plan loans, compliance testing, and plan audits. Many employers voluntarily pay for certain expenses that could be charged to the plan and its participants, such as recordkeeping, administrative, auditing, and certain legal expenses. Other employers design their plans to avoid certain expenses, such as discrimination testing. On the other hand, investment expenses, such as expenses of a particular mutual fund or other investment option, are generally borne by the participant whose account is invested in the fund.

Are Plan Fees Too High?

Marketplace competition among investment options and service providers is intense, which exerts downward pressure on fee levels. In fact, often plan investment fees are much lower than the fees charged outside the context of 401(k) plans. For example, a 2007 study by the Investment Company Institute found that in 2006 the average asset-weighted expense ratio for 401(k) plans investing in stock mutual funds was 0.74%, compared to a 0.88% average for all stock mutual funds.

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

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

Additional Principles With Respect To Plan Fee Issues.

There has been a vigorous and informative public policy discussion during the current year regarding plan fee issues. Based on that helpful discussion, we offer the following additional principles regarding modification of plan disclosure rules.

- **Reform of existing rules regarding electronic communication is needed to facilitate less expensive, more efficient forms of communication, including the use of internet and intranet postings.** Consideration should be given to adopting rules at least as workable as the Internal Revenue Service's rules regarding electronic communication. Such rules ensure that electronic communications are only used with respect to participants who can access such communications; at the same time, the Service's rules are also generally workable for plans. Without the effective ability to use electronic communication, compliance with extensive new disclosure rules would be unreasonably costly and burdensome.

- **Where disclosure to participants of exact dollar amounts of fees would be costly, the use of estimates or examples based on prior year data should be permitted.** Disclosure of exact dollar amounts of fees to participants would be enormously costly. Consider, for example, the difficulty of calculating fees which are based on a percentage of assets or are based on the number of participants. As participants move in and out of investment funds on a daily basis throughout the year, determining the precise dollar amount of fees charged for the year would require tremendous work as well as new recordkeeping systems. Very helpful fee information can be conveyed efficiently through the disclosure of expense ratios and reasonable estimates; the cost of turning those estimates into precise numbers would be very high and clearly not justified by the marginal difference between a reasonable estimate and the exact number.

- **Where disclosure of exact dollar amounts to plan fiduciaries would be costly, the disclosure of fee formulas to plan fiduciaries should be permitted.** As in the case of participant disclosure, disclosure of exact fee dollar amounts to plan fiduciaries could be extremely expensive in circumstances where fees are based on the number of participants as well as where fees are based on a percentage of assets. Plan fiduciaries only need the fee formula (such as the basis points charged); that will give them all the tools they need to evaluate the cost of the service. The high cost of calculating exact dollar amounts clearly outstrips the value of such exactitude.

- **If asset-based fees embedded in an investment option pay for other services, such as recordkeeping or other administrative services, this fact should be disclosed to plan fiduciaries and participants.**

- **Plan fiduciaries should retain flexibility to determine the format (as opposed to content) for disclosure based on the nature, expectations, and other attributes of their workforce.**

- **The rules must be flexible enough to accommodate the full range of possible investment choices that are or may be used in 401(k) plans, including those providing a guaranteed rate of return based on the general assets of the provider.**

- **Fee information should be disclosed in the manner in which fees are charged. Artificial division of a single "bundled" fee into components that are not commercially available separately at that cost serves no purpose. Service providers should be required to disclose what services are included in the "bundle" and what services can be purchased separately by the plan fiduciary.** The rules should not require "unbundling the bundle", i.e., a service provider should not be required to ascribe separate fees to services that are not sold separately by the service provider. This is not meaningful information. It is burdensome and costly to produce; it may be proprietary information; it has no significance since the services cannot be purchased separately from the service provider; and accordingly, it would not further fiduciaries' understanding of their options.

  Plan fiduciaries can reasonably make the decision whether to purchase services on a bundled or unbundled basis. Some fiduciaries believe, for example, that bundling provides economies of scale and facilitates efficient shopping for service providers, especially with respect to plans maintained by small employers. If the plan fiduciary understands the services that will be performed and the total cost of the service arrangement, it will be able to compare the overall cost and quantity of the bundled provider's offer with an unbundled arrangement available to the plan, and fulfill its responsibility to enter into reasonable service arrangements.

  A plan fiduciary purchasing services on a bundled basis retains the duty to determine if (1) the bundled package of services is appropriate for the plan, and (2) the bundled price is reasonable, both initially and over time. This will require the plan fiduciary to monitor, for example, whether any asset-based fees continue to be reasonable, especially with respect to services that do not vary based on the size of the plan assets. Again, for some fiduciaries, those monitoring tasks may be simpler in the bundled context than where there are multiple providers with respect to a single plan.

- **Disclosure of revenue sharing received by plan service providers from third parties should be required. Disclosure of the affiliation between two or more service providers should also be disclosed. However, payments from one**

service provider to another affiliated service provider are not revenue sharing and should not be required to be disclosed. Affiliates are part of one economic unit, so that any explicit payments between them may not reflect an arm's length transaction and thus may have little or no significance. Moreover, financial relationships between affiliates can be complex, including numerous non-market transactions, such as the exchange of services without any charges; in this context, calculating the value of "revenue sharing" would require identifying and valuing all of these non-market transactions and would thus be enormously difficult and uncertain.

In short, determining the value of intra-affiliated group payments would be costly and filled with speculation and uncertainty. Also, in light of the relationship between the entities, such payments are not revenue sharing in a true sense.

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

- **The rules should not require disclosure of transactions among service providers that are not directly related to the plan.** A large service provider with respect to a plan may enter into thousands of transactions with affiliated and unaffiliated companies, some of which may have unrelated dealings with the same plan. Disclosure of such transactional relationships would be enormously burdensome, as well as meaningless for the plan.

- **Fees paid by plan sponsors should not be subject to any of the disclosure rules. Where plan assets are not involved, ERISA's fiduciary rules are not implicated.**

- **Fees charged by service providers to plans should be disclosed. Fees charged to service providers by their suppliers have no relevance to plans and should not be required to be disclosed.** The rules should not require disclosure of a service provider's transactions with its suppliers, of which there could be a huge number. These suppliers have no contractual relationship to the plan, so any requirement to disclose such suppliers would, in addition to being extremely burdensome, be meaningless for the plan.

Conclusion.

We are very supportive of enhanced disclosure of plan fees. But fee disclosure must be addressed in a way that does not undermine participant confidence in the retirement system and does not create new costs that have the counterproductive effect of increasing fees borne by participants. We are committed to working with the government to make improvements in the fee disclosure area. We believe that the best approach to the fee issue is through simple, clear disclosures that enable plan sponsors and participants to understand and compare fees in the context of the services and benefits being offered under the plan.