The ERISA Industry Committee

Advocating the Employee Benefit and Compensation Interests of America's Major Employers

1400 L Street, NW, Suite 350, Washington, DC 20005 Tel: (202) 789-1400 Fax: (202) 789-1120 ww.eric.org

WRITTEN STATEMENT

OF

THE ERISA INDUSTRY COMMITTEE

BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
EDUCATION AND LABOR COMMITTEE

IN THE HEARING
ON
THE 401(K) FAIR DISCLOSURE FOR
RETIREMENT SECURITY ACT OF 2009

WEDNESDAY, APRIL 22, 2009

Chairman Miller, Ranking Member McKeon, and Members of the Committee, The ERISA Industry Committee thanks you for the opportunity to submit this written statement on the 401(k) Fair Disclosure for Retirement Security Act of 2009.

ERIC is a nonprofit association committed to the advancement of America's major employer's retirement, health, incentive, and compensation plans. ERIC's members' plans are the benchmarks against which industry, third-party providers, consultants, and policy makers measure the design and effectiveness of other plans. These plans affect millions of Americans and the American economy. ERIC has a strong interest in protecting its members' ability to provide the best employee benefit, incentive, and compensation plans in the most cost effective manor.

Let me begin by saying that ERIC strongly supports concise, effective, and efficient fee disclosure to participants. We support increased transparency between service providers and plan sponsors, and between plan sponsors and participants. ERIC has strong concerns that the legislation would sharply increase compliance costs and litigation threats by adding complexity and new requirements well beyond what is necessary to enhance the ability of plan participants to make good investment choices or the ability of plan sponsors to select the best service provider.

The Current System

Numerous aspects of ERISA already safeguard participants' interests and 401(k) assets. Plan assets must be held in a trust that is separate from the employer's assets. The fiduciary of the trust (normally the employer or committee within the employer) must operate the trust for the *exclusive* purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. In other words, the fiduciary has a duty under ERISA to ensure that any expenses of operating the plan, to the extent they are paid with plan assets, are reasonable.

It is important that as it considers new legislation, Congress fully understand the realities of fees in 401(k) plans. The vast majority of participants in ERISA plans have access to capital markets at *lower cost* through their plans than the participants could obtain in the retail markets because of economies of scale and the fiduciary's role in selecting investments and monitoring fees. The level of fees paid among all ERISA plan participants will vary considerably, however, based on variables that include plan size (in dollars and/or number of participants), participant account balances, asset mix, and the types of investments and the level of services being provided. Larger, older plans typically experience the lowest cost.

A study by CEM Benchmarking Inc. of 88 US defined contribution plans with total assets of $512 billion (ranging from $4 million to over $10 billion per plan) and 8.3 million participants (ranging from fewer than 1,000 to over 100,000 per plan) found that total costs ranged from 6 to 154 basis points (bps) or 0.06 to 1.54 percent of plan assets in 2005. Total costs varied with overall plan size. Plans with assets in excess of $10 billion averaged 28 bps while plans between $0.5 billion and $2.0 billion averaged 52 bps. In a separate analysis conducted for PSCA, CEM reported that, in 2005, its private sector corporate plans had total average costs of 33.4 bps and median costs of 29.8 bps.

Other surveys have found similar costs. HR Investment Consultants is a consulting firm providing a wide range of services to employers offering participant-directed retirement plans. It publishes the 401(k) Averages Book that contains plan fee benchmarking data. The 2008 edition of the book reveals that average total plan costs ranged from 140 bps for plans with 25 participants to 112 bps for plans with 5,000 participants. The Committee on the Investment of Employee Benefit Assets (CEIBA), whose more than 115 members manage $1.4 trillion in defined benefit and defined contribution plan assets on behalf of 16 million (defined benefit and defined contribution) plan participants and beneficiaries, found in a 2005 survey of members that plan costs paid by defined contribution plan participants averaged 22 bps.

It is important that before Congress considers any legislation in an effort to enhance disclosure of these fees that they fully understand the great deal many employees are already enjoying in their 401(k) plans.

Principles of Reform

As I said earlier, ERIC does not oppose effective and efficient disclosure efforts. Working together with 11 other trade associations, ERIC developed a comprehensive set of principles that should be embodied in any efforts to enhance participant fee disclosure.

- **Sponsors and Participants' Information Needs Are Markedly Different.** Any new disclosure regime must recognize that plan sponsors (employers) and plan participants (employees) have markedly different disclosure needs.

- **Overloading Participants with Unduly Detailed Information Can Be Counterproductive**. Overly detailed and voluminous information may impair rather than enhance a participant's decision-making.

- **New Disclosure Requirements Will Carry Costs for Participants and So Must Be Fully Justified.** Participants will likely bear the costs of any new disclosure requirements so such new requirements must be justified in terms of providing a material benefit to plan participants' participation and investment decisions.

- **Information About Fees Must Be Provided Along with Other Information Participants Need to Make Sound Investment Decisions.** Participants need to know about fees and other costs associated with investing in the plan, but not in isolation. Fee information should appear in context with other key facts that participants should consider in making sound investment decisions. These facts include each plan investment option's historical performance, relative risks, investment objectives, and the identity of its adviser or manager.

- **Disclosure Should Facilitate Comparison But Sponsors Need Flexibility Regarding Format**. Disclosure should facilitate comparison among investment options, although employers should retain flexibility as to the appropriate format for workers.

- **Participants Should Receive Information at Enrollment and Have Ongoing Access Annually.** Participants should receive fee and other key investment option information at enrollment and be notified annually where they can find or how they can request updated information.

ERIC strongly urges that the requirements of the 401(k) Fair Disclosure for Retirement Security Act be measured against these background principles.

<u>The Legislation's Service Provider Disclosures</u>

The Act would require plan service providers to provide a disclosure that describes all plan fees, in three specific categories, as well as additional categories to be later determined by the Secretary of Labor, as a condition of entering into a contract. The proposal would also require that this information be broken down into these cost components. The statement must describe the nature of any financial relationships, the impact of mutual fund share classes, and if revenue sharing is used to pay for "free" or "discounted" services.

In general, ERIC is concerned that the bill effectively makes plan sponsors liable for the actions of service providers. Such a structure would create an endless opportunity for litigation as lawyers seek to make plan sponsors guarantors of investment success. This would likely lead some plan sponsors to drop or curtail their plans to avoid the liability created by the bill.

Disclosure Provisions

ERIC also has several concerns with the specific disclosure provisions included in this section of the bill. ERIC believes that the requirement to provide individual costs in specific categories is not particularly helpful and would lead to information that is not meaningful. It also raises significant concerns as to how a service provider would disclose component costs for services that are not offered outside a bundled contract. Any such unbundling would be subject to a great deal of arbitrariness.

The posting of detailed unbundled services information could also force the public disclosure of proprietary information regarding contracts between service providers and plan sponsors. Compliance with this provision will require a substantial expenditure of time and effort to generate numbers that currently do not exist, are at best gross approximations, and are of extremely little practical value. These costs will ultimately be passed on to plan participants through higher administrative fees. A recent study indicates that between 2006 and 2008 litigation targeting private employee benefit plan sponsors has more than doubled.[1] While sponsors have tended to prevail in these cases, many of which are in fact "strike suits," engineered to force a plan sponsor to settle rather than undergo the rigors of even successfully defending endless litigation, the increase is litigation is a singular disincentive to create and maintain employee benefit plans.

ERISA currently requires plan administrators to ensure that the aggregate price of all services in a bundled arrangement is reasonable at the time the plan contracts for the services and that the aggregate price for those services continues to be reasonable over time. For example, asset-based fees should be monitored as plan assets grow to ensure that fee levels continue to be reasonable for services with relatively fixed costs such as plan administration and per-participant recordkeeping. The plan administrator should be fully informed of all the services included in a bundled arrangement to make this assessment.

Many plan administrators, however, may prefer reviewing costs in an aggregate manner and, as long as they are fully informed of the services being provided, they can compare and evaluate whether the overall fees are reasonable without being required to analyze each fee on an itemized basis.

Financial Relationships Provisions

ERIC also has concerns regarding the "financial relationship" provisions. ERISA already prescribes strict rules for prohibited activities for service providers who are parties-in-interest or fiduciaries to a plan. While disclosure of relationships is important, the provision goes much further by requiring the disclosure of relationships and affiliations between different providers, regardless of whether these relationships involve a conflict of interest.

ERIC is concerned that these provisions might be seen as creating a new set of fiduciary obligations on plan administrators and increase the likelihood of litigation. We are concerned that a plan sponsor fiduciary might find itself challenged for retaining a service provider after having a financial or personal relationship disclosed to it because the proposed legislation labeled the relationship as one involving a financial relationship. It should be clear that this section does not create any new requirements and mirrors the prohibited transactions in ERISA.

Share Class Disclosure

The purpose of the share class disclosure requirement is not clear. Depending on the size of a plan and its service needs, participants may pay fees that are lower, higher, or the same as "retail" prices. There are myriad costs associated with administering a 401(k) plan that do not apply to individual ownership of a mutual fund and, for this reason, participants in some plans, particularly new small business plans, may pay additional costs. A comparison with an "institutional" share in this situation could result in an

[1] Pension Governance, Inc. and The Michel-Shaked Group, *ERISA Litigation Study* at 9 (Apr. 15, 2009).

incorrect conclusion that the plan is paying more than reasonable expenses despite the requirement that the basis for such differences must be disclosed.

Estimates

While ERIC appreciates the attempt to ease the burden of calculating numbers that are not known and in many cases unknowable and/or unobtainable from a practical perspective by allowing for the use of some estimates, this section would create substantial potential liability for plan sponsors. This section's language would result in plan sponsors litigating whether it had "known" such information and whether its estimate of expenses was "reasonable." The substantial risk of litigation would ultimately lead many, especially small and mid-size, plan sponsors to discontinue or substantially curtail their retirement programs—a result that is in no one's best interest.

<u>The Legislation's Plan Participant Disclosure</u>

The requirements of the Act for participant fee disclosure are numerous, burdensome, complex, and likely to increase participant confusion rather than enhance participant knowledge. Under the Act, plan administrators must provide an advance notice of investment election information to participants and beneficiaries, generally 10 days prior to the beginning of the plan year.

The proposed notice must include the name of each option, the investment objectives and principal investment strategies of the option, the risk level associated with the option, whether the option is diversified among various classes of assets so as to minimize the risk of large losses or should be combined with other options so as to obtain such diversification, whether the investment option is actively managed or passively managed in relation to an index and the difference between the two, and where and the manner in which additional plan-specific, option-specific, and generally available investment information about the option may be obtained.

The notice must include a statement explaining that investment selection should not be based solely on fees but on other factors such as risk and historical returns. The notice must include a plan fee comparison chart of the potential service fees that could be assessed against the account in the plan year. Fees must be categorized as, 1) asset-based charges varying by investment option (including expense ratios, investment fees, redemption fees, surrender charges); 2) asset-based charges assessed regardless of investment option selected; and 3) administration and transaction-based charges, including plan loan fees, that are either automatically deducted each year or result from certain transactions. The fee chart shall include a general description of the purpose of each fee, i.e., investment management, commissions, administration, recordkeeping.

Again, ERIC supports disclosure of relevant fee information, but flexibility should be provided to ensure that the plan administrator could tailor the disclosure to meet the needs of plan participants. The participant disclosure requirements as presently drafted will likely result in lengthy "legalese" documents that would confuse most participants and possibly hinder rather than help them make investment decisions. The scope and detail of the disclosure might well result in a document that, at best, is ignored and, at worst, deters participation in the plan.

ERIC agrees that fee information should not be provided in a vacuum. Doing so would lead some participants to merely select the lowest cost option without regard to whether the risk and return of that option are appropriate for the participant. Some of the required data elements and comparisons in the legislation use confusing terminology, have overlapping requirements, or are excessively detailed. In many cases the required participant disclosure item would apply to some products and not others, and could be difficult to calculate, especially by the plan administrator.

The Legislation's Annual Benefit Statement

The Act would also require plan administrators to provide a detailed quarterly benefits statement that is impractical and costly. It includes starting balance; contributions by employer and employee during the plan year; earnings during the plan year; fees assessed in the plan year; ending balance; asset allocation by investment option, including current balance, annual change, net return as an amount and a percentage; service fees charged in the year for each investment.

Recordkeeping systems are not currently able to meet all the requirements of the quarterly benefits statement in the Act. Additional costs to participants will result from the significant system changes needed to comply and simpler disclosure would provide much of the same benefits to participants.

The Legislation's Changes to 404(c)

The Act would mandated that plans include at least one investment option which is an unmanaged or passively managed mutual fund designed to reflect the entire United States equity market, entire United States bond market, or a combination thereof that offers a combination of historical returns, risks, and fees that is likely to meet retirement income needs at adequate levels of contribution.

ERIC strongly believes that specific investment options should not be mandated by law (with resulting fiduciary liability if the investment is found not to meet statutory and regulatory requirements). The provision would override a plan's ability to select and monitor plan investments by reaching a values conclusion that this investment is appropriate for all plans. It sets a precedent for further mandates regarding the investment of plan assets which is counter to ERISA's focus on a prudent process and would preempt the judgment of investment professionals. It is unlikely that any one mutual fund—regardless of investment strategy—alone is "...likely to meet retirement income needs." Further, embedding a particular investment option in law may lead participants to believe that this is either the "best" option or the government-sanctioned option even if the plan does not contain a statement that such option is endorsed by the plan sponsor or the Government, thereby steering plan participants into the investment which may not be appropriate for the individual participant.

The Legislation's Effective Date

ERIC is concerned that numerous changes to recordkeeping systems would be required to meet the bill's various provisions. In addition, the bill includes no transition period for plan administrators who currently have contracts with service providers and would seem to endanger to the contractual relationships that exist between those parties.

Conclusion

ERIC supports effective fee disclosure, however, the Act is flawed in many regards. Plan sponsors and service providers alike are committed to creating new investment options and administrative techniques to improve retirement security. Automatic enrollment, automatic contribution step-ups, target-date and lifecycle funds, managed accounts are just some of the numerous innovations that have benefited 401(k) participants—indeed some of them may not even have been participants if not for such products—and enhanced their retirement security. Statutory requirements for fee disclosure would freeze disclosure in the present, making enhancements and innovations more difficult in the future.

ERIC recommends a comprehensive rewrite than ensures it comports with the principles we have outlined in our testimony. Any other result could jeopardize the future of the defined contribution system at a time when it is increasingly critical for American workers.

We appreciate the opportunity to submit our statement on this very important matter.