TESTIMONY OF

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ON BEHALF OF

THE ERISA INDUSTRY COMMITTEE
SOCIETY FOR HUMAN RESOURCE MANAGEMENT
NATIONAL ASSOCIATION OF MANUFACTURERS
UNITED STATES CHAMBER OF COMMERCE
AND
PROFIT SHARING/401K COUNCIL OF AMERICA

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

IN THE HEARING ON
H.R. 3185
THE 401(K) FAIR DISCLOSURE FOR RETIREMENT SECURITY ACT OF 2007

THURSDAY, OCTOBER 4, 2007

Chairman Miller, Ranking Member McKeon, and Members of the Committee, thank you for the opportunity to appear before you today to discuss H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007. My name is Lew Minsky and I am a Senior Attorney at Florida Power and Light Company. I am responsible for the legal issues relating to FPL's employee benefit plans and executive compensation arrangements. We currently offer two defined contribution plans covering 15,000 participants. I am testifying today on behalf of The ERISA Industry Committee (ERIC), the Society for Human Resources Management, the National Association of Manufacturers (NAM), The United States Chamber of Commerce, and the Profit Sharing/401k Council of America (PSCA).

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

The Society for Human Resource Management (SHRM) is the world's largest association devoted to human resource management. The Society serves the needs of HR professionals and advances the interests of the HR profession. Founded in 1948, SHRM has more than 225,000 members in over 125 countries, and more than 575 affiliated chapters.

The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The vast majority of NAM members provide 401(k) plans for their employees and thus have a significant interest in this legislation.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states, as well as 105 American Chambers of Commerce abroad. Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Established in 1947, PSCA is a national, non-profit association of 1,200 companies and their 6 million plan participants. PSCA represents its members' interests to federal policymakers and offers practical, cost-effective assistance with profit sharing and 401(k) plan design, administration, investment, compliance and communication. PSCA's services are tailored to meet the needs of both large and small companies. Members range in size from Fortune 100 firms to small, entrepreneurial businesses.

Let me begin by saying that we all strongly support concise, effective, and efficient fee disclosure to participants. We support increased transparency between service providers and plan sponsors, and between plan sponsors and participants. We all share strong concerns that H.R. 3185 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 2007 edition of the book reveals that average total plan costs ranged from 159 bps for plans with 25 participants to 107 bps for plans with 5,000 participants. The Committee on the Investment of Employee Benefit Assets (CEIBA), whose more than 115 members manage $1.4 trillion in defined benefit and defined contribution plan assets

on behalf of 16 million (defined benefit and defined contribution) plan participants and beneficiaries, found in a 2005 survey of members that plan costs paid by defined contribution plan participants averaged 22 bps.

It is important that before Congress consider 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.

Current Regulatory Action on Fees

Fee disclosure and transparency present complex issues. Amending ERISA through legislation to prescribe specific fee disclosure will lock in disclosure standards built around today's practices and could discourage product and service innovation. The Department of Labor (DOL) has announced a series of regulatory initiatives that will make significant improvements to fee disclosure and transparency**. We support the DOL's efforts and have been active participants in them. While legislative oversight of DOL's disclosure efforts is appropriate, we believe that this is the best approach to enhance fee transparency in a measured and balanced manner and we urge Congress to delay taking legislative action until the Department has completed its work**.

Among DOL's fee disclosure efforts are revised annual reporting requirements for plan sponsors. We expect DOL to release finalized modifications to the Form 5500 and the accompanying Schedule C, on which sponsors report compensation paid to plan service providers, within the next few weeks. The modifications will expand the number of service providers that must be listed and impose new requirements to report service provider revenue-sharing. The final regulations implementing the new Form 5500 are expected to first be applicable to the 2009 plan year.

DOL also intends later this year to issue a revised regulation under ERISA Section 408(b)(2), which is a statutory rule dictating that a plan may pay no more than reasonable compensation to plan service providers. The expected proposal is designed to ensure that plan fiduciaries have access to information about all forms and sources of compensation that service providers receive (including revenue-sharing). Both sponsors and providers will be subject to new legal requirements under these proposed rules, including an anticipated requirement that all third party compensation be disclosed in contracts or other service provider agreements with the plan sponsor.

The DOL's remaining initiative focuses on revamping participant-level disclosure of defined contribution plan fees. DOL issued a Request for Information ("RFI") in April 2007 seeking comment on the current state of fee disclosure, the existing legal requirements, and possible new disclosure rules. Several of us filed individual comments and we all issued a joint response with seven other trade associations. DOL has indicated that it intends to propose new participant disclosure rules early in 2008 that will likely apply to all participant-directed individual account retirement plans.

Principles of Reform

As I said earlier, we do not oppose effective and efficient disclosure efforts. Working together with seven other trade associations, we 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.

We strongly urge that the requirements of H.R. 3185 be measured against these background principles.

H.R. 3185's Service Disclosure Statement

H.R. 3185 would require plan service providers to provide a "service disclosure statement" that describes all plan fees, in twelve specific detailed categories, as a condition of entering into a contract. The proposal would also require that this information be broken down by each cost component or be "unbundled." The statement

must describe the nature of any "conflicts of interests," the impact of mutual fund share class if other than "retail" shares are offered and if revenue sharing is used to pay for "free" services.

In general, we are 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

We also have several concerns with the specific disclosure provisions included in this section of the bill. First, the requirements of H.R. 3185 are duplicative with the existing fiduciary requirement that fees paid with plan assets be reasonable. The DOL's pending proposed regulatory changes under section 408(b)(2) likely will result in similar disclosures, provided at the same general point in time, as this new provision. Under the DOL's approach, the disclosures will be incorporated into fiduciary requirements regarding plan fees, making noncompliance a prohibited transaction.

Second, we believe that the requirement to "unbundled" bundled services and provide individual costs in many detailed categories is not particularly helpful and would lead to information that is not meaningful. It also raises significant concerns as to how a service provider would disclose component costs for services that are not offered outside a bundled contract. Any such unbundling would be subject to a great deal of arbitrariness. 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.

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.

Conflict of Interest Provisions

We also have concerns regarding the "conflicts of interest" 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 conflicts 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. Plan sponsors are expected to be provided with considerably expanded disclosures in the near future as the result of the DOL initiatives (in all likelihood sooner than if new legislation is enacted).

We are 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 conflict of interest. It should be clear that this section does not create any new conflict-of-interest definitions 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 incorrect conclusion that the plan is paying more than reasonable expenses.

Estimates

While we appreciate the attempt to ease the burden of calculating numbers which 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 (the scope of which is very unclear) and whether its estimate of expenses was "reasonable." Additionally litigation could arise regarding whether estimates were "materially incorrect." 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.

H.R. 3185's Plan Participant Disclosure

The requirements of H.R. 3185 for participant fee disclosure are numerous, burdensome, complex, and likely to increase participant confusion rather than enhance participant

knowledge. Under H.R. 3185, plan administrators must provide an advance notice of investment election information to participants and beneficiaries, generally 15 days prior to the beginning of the plan year. The notice must include the name of the option; investment objectives; risk level; whether the option is a "comprehensive investment designed to achieve long-term retirement security or should be combined with other options in order to achieve such security"; historical return and percentage fee assessment; explanation of differences between asset-based and other annual fees; benchmarking against a nationally recognized market-based index or other benchmark retirement plan investment; and where and how additional plan-specific and generally available investment information regarding the option can 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 fee menu of the potential service fees that could be assessed against the account in the plan year. Fees must be categorized as, 1) varying by investment option (including expense ratios, investment fees, redemption fees, surrender charges); 2) asset-based fees assessed regardless of investment option selected; and 3) administration and transaction fees, including plan loan fees, that are either automatically deducted each year or result from certain transactions. The fee menu shall include a general description of the purpose of each fee, i.e., investment management, commissions, administration, recordkeeping. The menu will also include disclosure of potential conflicts of interest that may exist with service providers or parties in interest, as directed by the Secretary of Labor.

Again, we support disclosure of relevant fee information, but flexibility should be provided to ensure that the plan administrator can 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.

We agree 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. For example, a "benchmark retirement plan investment" does not currently exist and no single benchmark is appropriate for every kind of investment. 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.

H.R. 3185's Annual Benefit Statement

H.R. 3185 would also require plan administrators to provide a detailed annual benefits statement that is impractical and costly. It includes starting balance; vesting status;

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, including, separately, investment fees (expense ratios and trading costs), load fees, total asset based fees (including variable annuity charges), mortality and expense charges, guaranteed investment contract (GIC) fees, employer stock fees, directed brokerage charges, administrative fees, participant transaction fees, total fees, and total fees as a percent of current assets; and the annual performance of the investment options selected by the participant as compared to a nationally recognized market based index.

Recordkeeping systems are not currently able to meet all the requirements of the annual benefit statement in H.R. 3185. 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. Much of the required data about the plan and the participant's account that can be ascertained by the plan administrator is already required to be disclosed in the new benefit statement mandated under the Pension Protection Act, yet there is no coordination of the two requirements.

H.R. 3185's Index Fund Mandate

H.R. 3185 would mandate that plans include at least one investment option which is a nationally recognized market-based index fund that, as determined by the DOL, offers a combination of historical returns, risks, and fees that is likely to meet retirement income needs at adequate levels of contribution.

We strongly believe 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 "market-based index" 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, thereby steering plan participants into the investment which may not be appropriate for the individual participant.

H.R. 3185's Effective Date

The effective date of H.R. 3185 is unrealistic. 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

We support effective fee disclosure. However, H.R. 3185 is flawed in many regards. We strongly believe that the additional flexibility inherent in the regulatory system make DOL a more appropriate place for new disclosure requirements. DOL already has numerous initiatives underway to enhance disclosure between plan sponsors and participants and between plan sponsors and service providers. Any new legislative requirements would likely only slow those efforts resulting in delayed reforms.

Plan sponsors and service providers alike are committed to creating new investment options and administrative techniques to improve retirement security. Automatic enrollment, automatic contribution step-ups, target-date and lifecycle funds, managed accounts are just some of the numerous innovations that have benefited 401(k) participants—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.

If the Committee proceeds with H.R. 3185, we recommend 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 appear before you today and testify on this very important matter.