ICI VIEWPOINTS

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Fortune's Assessment of Industry Stance on 401(k) Fees Is Misguided

An article in the July 2 issue of Fortune about the 401(k) system mischaracterizes 401(k) fees and requires correction.

The mutual fund industry has supported transparency of fees

Currently, mutual fund fees are clearly disclosed to investors in an easy to understand fee table near the top of every fund prospectus. In addition, 401(k) plan sponsors, or employers, often provide plan participants with "fund fact sheets" prepared by third-party vendors, which highlight fees and expenses along with investment objective and performance, among other things.

The mutual fund industry has strongly supported the new Department of Labor 401(k) fee disclosure rules. Keep in mind that about half of all 401(k) assets are invested through mutual funds; the other half are invested through vehicles such as separately managed accounts, collective investment funds, insurance products, and company stock. DOL appears to be trying to ensure greater uniformity of disclosures from service provider to service provider and investment type to investment type. For example, the disclosures that are already provided by mutual funds, such as expense ratios, management and other fees, and performance data, will now be required to be disclosed for other investment vehicles.

With such uniformity, both plan sponsors and participants should find it easier to make the comparisons needed for better informed investment choices. However, we caution that plan sponsors and investors need to consider the services obtained for the fees, not solely the absolute level of the fees.

Fees pay for services that are valuable to investors

The Fortune article describes at length the fees investors might pay but fails to explain what the fees pay for. All retirement savings systems—defined contribution, defined benefit pension, or hybrid approaches—involve fees and expenses. Among other things, fees cover the cost of investment management and services—including custodial, legal, transfer agent, and recordkeeping services—that are essential to the operation of retirement plans.

The new rules going into place will ensure comparable fee information across all investment options in a 401(k) plan and therefore help both plan sponsors and participants understand what they are getting for the fees they pay. But, plan sponsors and plan participants alike need to go beyond just focusing on fees and also consider the quality of the investment, including factors such as performance, risk profile, and investment strategy.

Research shows investors are sensitive to fees in a very competitive 401(k) market

Mutual fund shareholders and plan sponsors have shown themselves to be sensitive to fund fees and expenses. ICI research finds 401(k) investors in mutual funds tend to hold lower-cost funds with below-average portfolio turnover. The context for this is a very competitive 401(k) market, where many types of providers vie for a share of the market and many new services have been introduced in the past two decades. Employers and employees generally share the costs of operating 401(k) plans. As with any employee benefit, the employer typically determines how the costs will be shared. In addition, pension law ensures that 401(k) plan sponsors—generally, employers—are fiduciaries responsible for acting in the best interest of plan participants. The sponsor's choice of options offered in the 401(k) plan menu is held to this high standard.

Fees vary with fixed costs, fund focus, and range of services

The article erroneously implies that any 401(k) participant paying above the median fee for a particular investment category—such as stocks or bonds—is overpaying. The comparison is not that simple. For example, smaller plans—those with fewer participants or fewer assets—tend to have higher than average fees per participant or per dollar invested because of certain fixed costs. In addition, even within a given investment category, fund fees can vary because of differing investment focus or style (e.g., among equity funds, foreign equity fund fees tend to be higher than domestic equity fund fees) and differing services included in the fund fees. Finally, quality of service can vary with respect to the various components of customer service, such as educational materials, employee meetings, and the range of planning and guidance tools available to the plan sponsor and participants.

Reliance on the study by Demos, an advocacy group, is misplaced

Finally, the Fortune article relies on inaccurate fee information from Demos, an advocacy group calling for a "new retirement system." The eye-catching numbers in the Demos report are implausible, as detailed in an earlier ICI Viewpoints blog post. For example, the report's estimate of the average lifetime fees paid by 401(k) participants is significantly overstated. Deloitte and ICI conducted a study based on data from hundreds of 401(k) plans to determine the average annual fees for 401(k) plans in 2011, and found that the median participant-weighted "all-in" fee for plans was 0.78 percent, or approximately $248 for the year, per participant. The all-in fee totaled all administrative, recordkeeping, and investment fees.

You can find more 401(k) information and perspective at our 401(k) Resource Center.