

## COMMENT LETTER

July 20, 2007

# Institute Response to DOL Request for Information on Disclosure of Fees in Participant Directed Plans (pdf)

July 20, 2007 Office of Regulations and Interpretations Employee Benefits Security Administration, Room N-5669 U.S. Department of Labor 200 Constitution Avenue, N.W. Washington, DC 20210 Attention: Fee Disclosure RFI Ladies and Gentlemen: The Investment Company Institute<sup>1</sup> appreciates this opportunity to comment on the Department's Request for Information on fee and expense disclosure to participants in individual account plans. The Institute has long supported effective disclosure to participants and plan sponsors. The attached Policy Statement affirms that support and contains a chronology of the Institute's three decades of efforts to improve disclosure. In crafting 401(k) plan participant disclosure requirements, the Department should give priority attention to the following: Participants in all self-directed plans should receive simple, straightforward explanations about each investment option, including information on fees and expenses. This should apply regardless of product type, and regardless of whether the plan sponsor intends to comply with the Department's regulation under section 404(c) of ERISA. Fees and expenses are only one piece of necessary information. While the fees associated with a plan's investment options are an important factor participants should consider in making investment decisions, no participant should decide whether to contribute to the plan or allocate his or her account based solely on fees. In many plans the lowest fee option is a money market fund or other low-risk investment because these funds are the least costly to manage,<sup>2</sup> but it is not appropriate for 1 ICI members include 8,766 open-end investment companies (mutual funds), 670 closed-end investment companies, 440 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$11.242 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households. 2 In 2005, the asset-weighted average total mutual fund expense ratio for money market funds held in 401(k) plans was 0.42%, compared with 0.58% for bond mutual funds and 0.76% for stock mutual funds. Holden and Hadley, The Office of Regulations and Interpretations Fee Disclosure RFI Page 2 of 19 most participants to invest solely in these relatively lower return options. In plans offering investment in employer stock, the employer stock option fund may be the lowest fee option because essentially no active investment management is involved, but it also would not be appropriate for participants to invest solely in one security.<sup>3</sup> Any regulatory action by the Department to improve disclosure to participants in 401(k) plans should not place undue emphasis on fees over other vital pieces of information participants need to make informed investment decisions. While disclosure could be improved, the 401(k) system is working.

Institute research shows that participants generally make sensible choices in allocating their investments.<sup>4</sup> As we explain below, in the competitive mutual fund market, 401(k) savers also tend to concentrate their assets in low-cost funds. In 2005, 77% of stock mutual fund assets in 401(k) plans were invested in funds with a total expense ratio of less than 1.00%.<sup>5</sup> And collaborative research by the Institute and the Employee Benefit Research Institute demonstrates that a full career with 401(k) plans can produce adequate replacement rates at retirement.<sup>6</sup> The biggest challenge in ensuring adequate retirement security for all Americans lies in encouraging more small employers to offer a workplace plan. Disclosure reform should seek to improve the 401(k) system without imposing burdens, costs and liabilities that deter employers from offering plans. The Department's disclosure rules should codify best practices and leverage the Internet. Mutual funds and other financial service providers active in the 401(k) market have developed innovative ways to present key investment information in a concise format that participants value and

Economics of Providing 401(k) Plans: Services, Fees, and Expenses, ICI Fundamentals, vol. 15, no. 7 (November 2006), available at <http://www.ici.org/pdf/fm-v15n7.pdf>. 3 This point is made in the Department's publication for participants, Taking the Mystery Out of Retirement Planning, page 11, available at <http://www.dol.gov/ebsa/publications/NRTOC.html>. 4 For example, in 2005, participants in their 20s allocated 62% of their accounts to pooled equity investments and company stock, and only about 20% to GICs and other fixed-income investments. Participants in their 60s allocated nearly 40% to GICs and other fixed-income investments. See Holden and VanDerhei, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2005, ICI Perspective and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, August 2006, available at <http://www.ici.org/stats/res/per12-01.pdf>. The 2005 EBRI/ICI database contains 47,256 401(k) plans with \$1,026 billion in assets and 17.6 million participants. 5 See Economics of Providing 401(k) Plans: Services, Fees and Expenses, supra note 2. 6 See Holden and VanDerhei, Can 401(k) Accumulations Generate Significant Income for Future Retirees? and The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement, ICI Perspective and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, November 2002 and July 2005, respectively, available at <http://www.ici.org/pdf/per08-03.pdf> and <http://www.ici.org/pdf/per11-02.pdf>, respectively. The latter research was cited in the Department's default investment proposal. See 71 Fed. Reg. 56806 n.1 (September 27, 2006). Office of Regulations and Interpretations Fee Disclosure RFI Page 3 of 19 use. The Internet is a particularly effective and efficient means to deliver disclosure, because of its ability to offer layers of information. Disclosure rules should focus on the decisions participants have to make and the information they need to make those decisions. The purposes behind fee disclosure to plan sponsors and participants differ. Participants have only two decisions to make: whether to contribute to the plan (and at what level) and how to allocate their account among the investment options the plan sponsor has selected. Disclosure should help participants make those decisions. Voluminous and detailed information about plan fees could overwhelm the average participant and could result in some employees deciding not to participate in the plan. On the other hand, plan sponsors, as fiduciaries, must consider additional factors in hiring and supervising plan service providers and selecting investment options. The Institute has consistently supported efforts to ensure plan sponsors have the detailed information they need as fiduciaries to select and monitor service providers and review the reasonableness of plan fees.<sup>7</sup> The Institute strongly supports the Department's decision to keep its project related to disclosure to plan fiduciaries under ERISA section 408(b)(2) distinct from this project related to participants. Our responses to the Department's specific questions are below. 1. What basic information do participants need to evaluate investment options under

their plans? If that information varies depending on the nature or type of investment option (options offered by a registered investment company, options offered under a group annuity contract, life cycle fund, stable value product, etc.), please include an explanation. Participants should receive the following key pieces of information for each investment product offered under the plan: • Types of securities held and investment objective of the product • Principal risks associated with investing in the product • Annual fees and expenses expressed in a ratio or fee table • Historical performance • Investment adviser that manages the product's investments<sup>7</sup> For example, see Statement of the Investment Company Institute on Disclosure to Plan Sponsors and Participants Before the ERISA Advisory Council Working Groups on Disclosure (September 21, 2004), available at [http://www.ici.org/statements/tmny/04\\_dol\\_krentzman\\_tmny.html](http://www.ici.org/statements/tmny/04_dol_krentzman_tmny.html). Office of Regulations and Interpretations Fee Disclosure RFI Page 4 of 19 This list is informed by research on what information investors actually consider before purchasing mutual fund shares.<sup>8</sup> The top items shareholders considered in making decisions included fund fees and expenses, historical performance, risks associated with the fund, and types of securities in which the fund invests. Our research also found that investors find a summary of information more helpful than a detailed document.<sup>9</sup> This basic information should be provided on all investment options available under the plan, regardless of type. Disclosure of this information is appropriate for mutual funds, insurance separate accounts, bank collective trusts, and separately managed accounts. In discussing fees and expenses, for example, the disclosure for any pooled vehicle should disclose the operating expenses of the pooled fund. In discussing the principal risks, the disclosure should explain the risks associated with the stated investment objectives and strategies. The same key pieces of information are relevant and should be disclosed for fixed-return products, where a bank or insurance company promises to pay a stated rate of return. In describing fees and expenses of these products, for example, the disclosure should explain that the cost of the product is built into the stated rate of return because the insurance company or bank covers its expenses and profit margin by any returns it generates on the participant's investment in excess of the guaranteed rate of return. In describing principal risks of these products, the summary should explain that the risks associated with the guaranteed rate of return include the risks of interest rate changes, the long-term risk of inflation, and the risks associated with the product provider's insolvency.

2. What specific information do participants need to evaluate the fees and expenses (such as investment management and 12b-1 fees, surrender charges, market value adjustments, etc.) attendant to investment options under their plans? If that information varies depending on the nature or type of option, or the particular fee arrangement relating to options (e.g., bundled service arrangements), please include an explanation. Participants should receive information on annual operating expenses<sup>10</sup> for any product where the investment return is based on the return of the underlying assets minus the operating expenses<sup>8</sup> See Understanding Investor Preferences for Mutual Fund Information, Investment Company Institute (2006), available at [http://www.ici.org/pdf/rpt\\_06\\_inv\\_prefs\\_full.pdf](http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf). The study included in-home interviews with 737 randomly selected investors who had purchased shares in stock, bond, or hybrid mutual funds outside retirement plans at work in the preceding five years. Although this study focused on investors who purchased mutual funds in the retail market, we believe its findings are relevant to the decisions participants make in employer plans. <sup>9</sup> Nearly nine in ten shareholders prefer a summary of mutual fund information, either by itself or along with a detailed document. See Understanding Investor Preferences for Mutual Fund Information, *supra* note 8. <sup>10</sup> A mutual fund prospectus includes a standardized fee table that sets forth total expenses, which is the most relevant number to most investors. The fee table also breaks the total expense ratio into components—investment management, Office of Regulations and Interpretations Fee Disclosure RFI Page 5 of 19 (including investment

management, distribution expenses, mortality and expense (M&E) charges, insurance wrap fees, and bank insurance protection fees), as long as those expenses are being borne by the participant. This would include mutual funds, bank collective trusts, separately managed accounts, and variable insurance products. A product should not be exempt from this requirement solely because it has some insurance features, such as a death benefit or annuity right at distribution. The needs of participants would be best served by requiring a simplified disclosure statement to include the total expense ratio. For most participants this is the key number. If the Department determines to require a breakdown of an expense ratio into constituent parts (such as the mutual fund expense ratio depicted in a mutual fund fee table), it should require the same of all similar investment products, to preserve comparability. In addition, the Department should require disclosure of any transaction fees imposed at the time of purchase (brokerage or insurance commissions, sales charges or front loads<sup>11</sup>) or at the time of sale or redemption (redemption fees, deferred sales loads, surrender fees, market value adjustment charges). For products with these charges, it is important that participants be informed of them before investing. Some “costs” of investing are not part of operating expenses, such as brokerage commissions. Instead, brokerage commission costs reduce the fund’s capital gain (or increase capital loss) on a portfolio security investment. The effect of brokerage commissions and other trading costs are disclosed in fund performance, however. Mutual funds provide information on the fund’s portfolio turnover rate in the prospectus and semi-annual shareholder reports and on brokerage commissions in the fund’s Statement of Additional Information. While information on commissions could be helpful to a plan sponsor in selecting the plan’s investment line-up, most participants will not find this information useful in making investment allocations.<sup>12</sup> This information should be available upon request or on the Internet.<sup>13</sup> distribution (12b-1), and other expenses. The fee table also discloses any transaction costs (e.g. sales charges) associated with investing in the fund. 11 Front loads are not common in defined contribution plans. As of 2005, almost three-quarters of mutual fund assets in 401(k) plans were held in no-load funds. The remaining one-quarter was held in load funds, but predominately in fund shares that do not charge retirement participants a front-end load. See *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, supra note 2. 12 Other so-called transaction costs, such as “spread costs,” “market impact costs,” and “opportunity costs,” cannot be quantified and expressed with accuracy. These costs are disclosed indirectly, however, in fund performance information. See Institute Letter to the SEC re: Commission Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs (File No. S7-29-03) (February 23, 2004), available at: [http://www.ici.org/statements/cmltr/2004/04\\_sec\\_port\\_disclose\\_com.html](http://www.ici.org/statements/cmltr/2004/04_sec_port_disclose_com.html). 13 Any disclosure requirements imposed by the Department regarding trading costs should apply to all investment options where trading affects the product’s investment return. Office of Regulations and Interpretations Fee Disclosure RFI Page 6 of 19 3. To what extent is the information participants need to evaluate investment options and the attendant fees and expenses not currently being furnished or made available to them? Should such information be required to be furnished or made available by regulation or otherwise? Who should be responsible for furnishing or making available such information? What, if any, additional burdens and/or costs would be imposed on plan sponsors or plans (plan participants) for such disclosures? As the Government Accountability Office found, current disclosure rules produce uneven disclosure, depending both on whether the plan seeks to comply with ERISA section 404(c) and whether an investment option is registered under the Securities Act of 1933.<sup>14</sup> One important gap is that plans that do not rely on section 404(c) are not required to provide any particular investment information to participants. In plans complying with section 404(c), the Department does not currently require that participants receive annual fee or historical return information unless they affirmatively ask for it (and

then only if the plan has that information). On the other hand, participants automatically receive this information with respect to mutual funds and other products registered under the 1933 Act because the Department requires that they receive a prospectus. In practice, some providers of stable value funds or other pooled products that are not registered under the 1933 Act provide disclosure modeled on mutual fund disclosures, while others provide narrative information which may only contain some of the information mutual fund investors receive. Plans should be required to provide the key investment information for each investment option. The plan administrator (or other designated plan fiduciary) should have the obligation to provide this information, although financial service providers and retirement plan recordkeepers will continue to play a role in producing this information in a form that can be given to participants. The costs associated with disclosure generally are paid by participants, through increased investing costs, increased account charges, or a decrease in another component of employee compensation. We believe that the changes we recommend will not impose material costs or significant burdens. In section 404(c) plans, the identified plan fiduciary (typically the plan administrator) already has an obligation to provide information for each investment option about investment objectives, risk and return characteristics, the identity of the investment manager, and transaction fees associated with the product. Adding historical performance and annual fees to that list should not impose significant burdens on plan fiduciaries or require product providers to incur costs in deriving this information. Voluminous and detailed additional disclosure, on the other hand, could create substantial burdens on plan sponsors, service providers, and investment products. For example, individualized disclosure of what a participant paid on a dollar basis would involve costly systems changes that would 14 Government Accountability Office, Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees, GAO-07-21 (November 2006), pp 18-19. Office of Regulations and Interpretations Fee Disclosure RFI Page 7 of 19 outweigh any benefit from this information. See answer to question #19, below. This is especially true where plan investment options come from a number of different providers. 4. Should there be a requirement that information relating to investment options under a plan (including the attendant fees and expenses) be provided to participants in a summary and/or uniform fashion? Such a requirement might provide that: A) all investment options available under a participant-directed individual account plan must disclose information to participants in a form similar to the profile prospectus utilized by registered investment companies; or B) plan fiduciaries must prepare a summary of all fees paid out of plan assets directly or indirectly by participants and/or prepare annually a single document setting forth the expense ratios of all investment options under the plan. Who should be responsible for preparing such documents? Who should bear the cost of preparing such documents? What are the burden/cost implications for plans of making any recommended changes? As stated above, we believe that participants should receive a summary with the key information for each investment option. The mutual fund profile permitted by Rule 498 under the Securities Act of 1933 (sometimes called the profile prospectus) is one way to provide summary information on mutual funds, but it is not the only way. It is common practice today to provide a "fund fact sheet" to 401(k) participants, although a fund profile is sometimes used instead. These helpful tools, which are typically limited to one or two pages, provide basic information about a fund's investment objectives, risk, historical performance, and fees, in a format that investors find useful. They often use charts and graphs, which investors prefer over narrative descriptions.<sup>15</sup> The SEC is developing a new streamlined disclosure document for mutual funds.<sup>16</sup> (SEC rules for using the document are expected to address liability issues that prevented the fund profile from gaining wide use.) These concise documents could serve as models for other products. We understand that the Department has begun coordination with the SEC. It is critical that any simplified disclosure

document that the SEC develops for mutual funds be consistent with what the Department requires in the context of 401(k) investors; otherwise, 401(k) investors will bear the costs of mutual funds operating under different disclosure regimes. The Department should not mandate that participants receive a list showing only the investment options under the plan and the expense ratio for each. Without the context of other key 15 See Understanding Investor Preferences for Mutual Fund Information, *supra* note 8. 16 See Statement of Securities Exchange Commission Before the House Financial Services Committee (June 26, 2007), available at

[http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/sec\\_testimony\\_\(6-26-07\).pdf](http://www.house.gov/apps/list/hearing/financialsvcs_dem/sec_testimony_(6-26-07).pdf).

Office of Regulations and Interpretations Fee Disclosure RFI Page 8 of 19 investment information—objectives, risks, historical performance—a list of this sort will elevate fees as a consideration above all else, and encourage inappropriate investment decisions. Fee information should always be disclosed in the context of the other key information participants need to make good investment decisions. Many plans make available only one investment option for a particular asset class or investing style. For example, there may be only one large cap growth stock fund, one small cap stock fund, one money market fund, one suite of lifecycle funds, etc. The average investor gains little from knowing that the plan's lifecycle retirement fund has an expense ratio of 0.75%, the money market fund has an expense ratio of 0.40%, and the plan's employer stock option has a zero expense ratio. Participants in these plans who look only at fees likely will make inappropriate long-term asset allocations. Institute research shows that retail mutual fund investors routinely consider other factors such as risks and historical performance in addition to fees before purchasing mutual fund shares.<sup>17</sup> The Department should not mandate that 401(k) participants receive a document that implies they should consider only one piece of information. 5. How is information concerning investment options, including information relating to investment fees and expenses, communicated to plan participants, and how often? Does the information or the frequency with which the information is furnished depend on whether the plan is intended to be a section 404(c) plan? Many Institute members that offer recordkeeping services to 401(k) plans provide the employer with "fund fact sheets" for each investment option under the plan. These fund fact sheets typically are available on a website maintained for the plan, so anytime a participant logs in he or she can access basic information about the plan's options (including those in which he or she is not invested). Disclosures similar to mutual fund fact sheets are often provided for stable value funds or other pooled products, although there tends to be less uniformity regarding products other than mutual funds. Some fund fact sheets provide a breakdown of a fund's expense ratio (by investment management, distribution (12b-1) and other administrative expenses). Other fund fact sheets simply disclose the total expense ratio. For most investors, the total expense ratio is the key number, and additional breakdown is available in the fund's prospectus. We understand from our members that the information or the frequency with which the information is furnished generally does not depend on whether the plan sponsor has determined the plan is a section 404(c) plan. Recordkeepers and third party administrators design their recordkeeping 17 See Understanding Investor Preferences for Mutual Fund Information, *supra* note 8. Office of Regulations and Interpretations Fee Disclosure RFI Page 9 of 19 systems, call centers, voice response systems, and websites to comply with section 404(c) disclosure requirements. 6. How does the availability of information on the internet pertaining to specific plan investment options, including information relating to investment fees and expenses, affect the need to furnish information to participants in paper form or electronically? Because of the increasing availability and use of the Internet, any rules issued by the Department should encourage and facilitate electronic disclosure of investment information. Web-based layered disclosure gives 401(k) participants both basic information and, for those seeking it, the

ability to “click through” to more detail. The Department’s rules should allow plans to make detailed information and documents, such as the mutual fund prospectus, available online or in paper upon request. Plans also should be able to provide the basic summary information that we recommend for every single investment option online, unless an employee does not have reasonable access to the Internet. 18 Access to the Internet is growing dramatically. The Institute has conducted extensive research on access to and use of the Internet by U.S. households generally and mutual fund investors specifically. An Institute study from 2005 reports that four out of five Americans have Internet access, up from less than one-quarter of Americans in 1997.<sup>19</sup> Among certain groups, such as those with a college education, Internet access is nearly universal, but Internet access also has grown significantly among other groups. For example, 64 percent of U.S. adults with a high school education or less report having Internet access in 2005, as compared to 10 percent in 1997. Only 8 percent of people age 55 or older had Internet access in 1997—by 2005, the number grew to 64 percent. Among those with a household income below \$50,000, the share with Internet access grew from 14 percent to 64 percent in that period (1997–2005).<sup>20</sup> A 2006 Institute study of Americans who own mutual funds (whether through employer plans or through the retail market) found that over 90 percent have access to the Internet. The study found that 71 percent of those with Internet access go online at least once a day. Three-quarters of 18 The Report of the 2006 ERISA Advisory Council’s Working Group on Prudent Investment Process also recommended relaxing the Department’s rules for electronic disclosure by moving to a “reasonable access” model. See [http://www.dol.gov/ebsa/publications/AC\\_1106A\\_report.html](http://www.dol.gov/ebsa/publications/AC_1106A_report.html). 19 See West and Leonard-Chambers, Mutual Fund Shareholders’ Use of the Internet, 2005, ICI Fundamentals, vol. 15, no. 2 (February 2006). 20 See Mutual Fund Shareholders’ Use of the Internet, 2005, supra note 19. Office of Regulations and Interpretations Fee Disclosure RFI Page 10 of 19 shareholders who go online use the Internet to access their bank or investment accounts, and 57 percent use the Internet to obtain investment information.<sup>21</sup> Most 401(k) plan recordkeepers maintain a website that gives participants continuous access to their accounts, continuous access to information about the plan’s investment options, and easy access to plan features. Many participants enroll online using this system, and at the time of enrollment, have web access to the key information about each investment option. Often each investment option’s key features are provided through interactive web pages, allowing “click through” to more detail and additional documents like prospectuses and annual reports. Our research finds that shareholders prefer a summary of mutual fund information instead of a detailed document. Only 34 percent of mutual fund shareholders surveyed indicated that they consulted the prospectus before making their most recent purchase of fund shares. About half indicated they generally do not read or read very little of the prospectus they receive.<sup>22</sup> Plans should have the option to make more detailed documents—such as mutual fund prospectuses and similar investor reports for other commingled products and insurance products—available online or in paper upon request.

7. What changes, if any, should be made to the section 404(c) regulation, to improve the information required to be furnished or made available to plan participants and beneficiaries, and/or to improve likelihood of compliance with the disclosure or other requirements of the section 404(c) regulation? What are the burden/cost implications for plans of making any recommended changes? As an initial matter, the Department should take the basic disclosure obligations out of section 404(c) and apply them to all participant-directed defined contribution plans. See answer to question #15, below. The current 404(c) disclosure rules impose special requirements on mutual funds and other investments subject to the Securities Act of 1933. For these investment options, plans must provide participants with a copy of the fund’s prospectus, which contains all the key information, including fees and historical performance. For other investment options, key information,

such as annual operating expenses and historical performance, is required to be provided only upon request and only if that information has been provided to the plan. 21 See West and Leonard-Chambers, *Ownership of Mutual Funds and Use of the Internet*, 2006, ICI Fundamentals, vol. 15, no. 6 (October 2006). 22 See Understanding Investor Preferences for Mutual Fund Information, *supra* note 8. Office of Regulations and Interpretations Fee Disclosure RFI Page 11 of 19 The Report of the 2006 ERISA Advisory Council's Working Group on Prudent Investment Process explained the gaps in the section 404(c) regulation this way: "Overall, the testimony received told the Working Group that the current disclosure system results in significant gaps in the information that participants receive about some products and can produce information overload with respect to other products. Several witnesses testified that while mutual funds are the easiest investment to understand by participants – mutual funds have the heaviest burden when it comes to disclosure. By the same token less regulated and harder to understand investments might not even provide information regarding fees and performance."23 8. To what extent should participant-directed individual account plans be required to provide or promote investment education for participants? For example, should plans be required or encouraged to provide a primer or glossary of investment-related terms relevant to a plan's investment options (e.g., basis point, expense ratio, benchmark, redemption fee, deferred sales charge); a copy of the Department's booklet entitled "A Look at 401(k) Fees" ([http://www.dol.gov/ebsa/publications/401k\\_employee.html](http://www.dol.gov/ebsa/publications/401k_employee.html)) or similar publication; or investment research services? Should such a publication include an explanation of other investment concepts such as risk and return characteristics of available investment options? Please explain views, addressing costs and other issues relevant to adopting such a requirement. It is common for plans to provide or promote investment education to participants.24 The Department should encourage participant education, including through its own website, but should not mandate specific requirements. Plan sponsors and service providers have long supported investment education for participants and mutual fund companies have been leaders and innovators in helping savers understand investing concepts. The Department provides various participant and sponsor education materials, including its "A Look at 401(k) Fees." Employers, service providers, and the Department all play a role in helping participants understand their plan, its investment options, and basic savings and investment concepts. The Department should continue to promote investment education, and continue to partner with stakeholders, but should not stifle innovation with mandates.25 23 Report of the 2006 ERISA Advisory Council's Working Group on Prudent Investment Process, available at [http://www.dol.gov/ebsa/publications/AC\\_1106A\\_report.html](http://www.dol.gov/ebsa/publications/AC_1106A_report.html). 24 See, e.g., Profit Sharing/401(k) Council of America (PSCA), 49th Annual Survey, Reflecting 2005 Plan Year Experience. 25 A mandate to provide investment education could lead plan fiduciaries to deluge participants with investment materials to ensure the plan has complied with the mandate. Office of Regulations and Interpretations Fee Disclosure RFI Page 12 of 19 Some plan sponsors and service providers may wish to develop their own materials and have the resources to do so. Others, especially small plans, may want to refer participants to the Department's materials. Both approaches provide participants access to cost-effective education. The Pension Protection Act requires that a participant's periodic pension benefit statement include an explanation of the importance of a well-balanced portfolio, including a statement that holding more than 20 percent of a portfolio in the security of one entity (such as employer securities) may not be diversified and a notice directing the participant to the Department's website for sources of information on individual investing and diversification. The Department's current website used to comply with the PPA26 includes a link to the Department's booklet on 401(k) fees, which is provided alongside other useful publications to help participants get the most out of their 401(k) plans. This approach



recognizes that fees, while important, are only one piece of information that participants should consider. 9. What information is currently furnished to participants about the plan and/or individual administrative expenses charged to their individual account? Such expenses may include, for example: audit fees, legal fees, trustee fees, recordkeeping expenses, individual participant transaction fees, participant loan fees or expenses. Where participants are assessed an overall administrative charge to their account (such as \$100 per year) which is not already reflected in the fees of the plan's investment options, that charge typically is shown on the participant's quarterly statement and may be disclosed to participants in some form at enrollment. The Department should require that any administrative charge assessed directly against the participant's account, and not reflected in the fees of the investment products available under the plan, be provided upon enrollment, or within a reasonable time thereafter. If the exact amount of the upcoming year's charge cannot be determined in advance, because the amount charged will depend on the actual expenses incurred by the plan's trust, then an estimate should be provided. Where an administrative charge is assessed to participants, it would not typically be divided into its constituent parts (such as recordkeeping, audit, trustee, or compliance).<sup>27</sup> The charge covers all the services that the plan fiduciary has hired the service provider(s) to provide. Breaking the administrative fee into constituent parts makes no more sense than a restaurant disclosing how much of the cost of a hamburger goes to pay for the bun, the meat, the lettuce, the ketchup, the wait service, and the dishwashing. <sup>26</sup> See <http://www.dol.gov/ebsa/investing.html>. See also Field Assistance Bulletin 2006-3 (December 20, 2006). <sup>27</sup> Plan participants play no role in negotiating the details of service arrangements and would have no context by which to judge the reasonableness of each constituent charge. Office of Regulations and Interpretations Fee Disclosure RFI Page 13 of 19 Individual participant transaction-based charges, such as loans or QDRO fees, are typically disclosed prior to a participant accessing that plan feature. Our members that provide recordkeeping services inform us that the fee also appears on the confirmation that is typically provided to participants (either by mail or electronically) after the service is accessed. The charge typically also will be shown on the quarterly statement. The Department should not require that these participant-initiated charges be disclosed at enrollment, but instead when the participant accesses the plan feature. 10. What information about administrative expenses would help plan participants, but is not currently disclosed? Please explain the nature and usefulness of such information. The key piece of information for participants is what charges will be assessed against their accounts in addition to any annual fees and transaction fees associated with the investment options they select. Some participants may not understand that the fees and expenses of the investment options may pay for both investment services and administrative services. To address this issue, the Department could mandate that participants be told, if it is the case, that a portion of the fees and expenses associated with the investment products are used to defray the cost of administering the plan and meeting regulatory requirements. The information needs of plan participants and plan sponsors are quite different. Detailed information about plan administrative costs and how fees and expenses are allocated among service providers will not help a participant make decisions as to how much to contribute to the plan and how to allocate his or her account. This information would be available to a participant who wishes to review it, for example, on the new Schedule C to Form 5500 proposed by the Department. Plans are required to provide Form 5500 to any participant who asks for it (and the summary annual report alerts participants to this fact). 11. How are charges against an individual account for administrative expenses typically communicated to participants? Is such information included as part of a participant's individual account statement or furnished separately? If separately, is the information communicated via paper statements, electronically, or via website access? See answer to

question #9, above. Some participants access their account statements online, or choose to receive statements electronically, in which case the information that is disclosed on the quarterly statement is also available via email or website access. Office of Regulations and Interpretations Fee Disclosure RFI Page 14 of 19 12. How frequently is information concerning administrative expenses charged to a participant's account communicated? Administrative charges that are not already reflected in the plan's investment options are typically disclosed on the quarterly benefit statement. See answer to question #9, above. In addition, participants served by our members will see the charge reflected in their online account when the charge is assessed. Where administrative expenses are part of the fees of the individual products, disclosure of those fees will be disclosed in conjunction with the investment product. For example, any fees of a mutual fund that are used to defray administrative expenses of the plan will be reflected in the expense ratio disclosed prominently in the fund's prospectus, and under our recommendation, will be included in the fund fact sheet or fund profile provided to participants upon enrollment. As suggested above, the Department could require that participants be told, if it is the case, that a portion of the fees and expenses of the investment products are used to defray the cost of administering the plan and meeting regulatory requirements. 13. What, if any, requirements should the Department impose to improve the disclosure of administrative expenses to plan participants? Please be specific as to any recommendation and include estimates of any new compliance costs that may be imposed on plans or plan sponsors. See answer to question #9, above. 14. Should charges for administrative expenses be disclosed as part of the periodic benefit statement required under ERISA section 105? Any individual charges to a participant's account incurred during the quarter should be disclosed in the periodic benefit statement. The periodic benefit statement, however, is not the place for duplicate disclosure of fees associated with each investment option. The fund's performance, and therefore the participant's account, will already reflect the fees of the investment option. Disclosure of fees associated with the plan's investment options on the periodic benefit statement could elevate fees above other important factors and encourage inappropriate investment allocations, just as it could upon enrollment. In addition, the periodic benefit statement covers only those investments in which the participant has invested, and not others available under the plan. Participants would be much better served by having access to updated copies of the fund fact sheets, either through the plan's website or in paper upon request. Office of Regulations and Interpretations Fee Disclosure RFI Page 15 of 19 15. What, if any, distinctions should be considered in assessing the informational needs of participants in plans that intend to meet the requirements of section 404(c) as contrasted with those of participants in plans that do not intend to meet the requirements of section 404(c)? There is no reason to differentiate the information needs of participants in section 404(c) plans versus those in non-section 404(c) plans. There is no policy justification to deny participants who have the right under the plan to direct the investment of their account the key information they need to make informed decisions. 16. What (and what portion of) plan administrative and investment-related fees and expenses typically are paid by sponsors of participant-directed individual account plans? How and when is such information typically communicated to participants? According to a survey conducted by Deloitte Consulting, LLP, International Foundation, and the International Society of Certified Employee Benefit Specialists, more than one-third (37 percent) of plan sponsors indicated that the company (plan sponsor) paid for all administrative and recordkeeping expenses:<sup>28</sup> 28 See The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, *supra* note 2. Office of Regulations and Interpretations Fee Disclosure RFI Page 16 of 19 17. How would providing additional fee and expense information to participants affect the choices or conduct of plan sponsors and administrators, and/or that of vendors of plan products and services? Please explain any

such effects. Mutual fund companies and other financial service providers already create and provide fund fact sheets or fund profiles with key investment information, including fees. Changes we recommend should not significantly affect their costs or behavior. Transparency promotes competition, which inures to the benefit of plans and participants. Although the disclosures we have discussed are designed for participants, availability of comparable streamlined disclosure about all investment products that includes performance, fees, risks and objectives, will help plan sponsors select and monitor the plan menu. This is especially important for plans that do not employ independent consultants to assist them in evaluating service arrangements and investments. However, disclosure overload may deter employers from offering plans or result in additional plan recordkeepers leaving the business.<sup>29</sup> Disclosure requirements with voluminous and detailed disclosure for each participant will require significant investment in recordkeeping systems that small or low margin service providers will be less able to absorb. See question #19, below. While all compliance costs create barriers to entry, disclosure requirements entailing expensive computer systems and interlocking data exchange could particularly affect smaller service providers.

18. How would providing additional fee and expense information to participants affect their plan investment choices, plan savings conduct or other plan related behavior? Please explain any such effects and provide specific examples, if available. The Institute believes that transparency of the kind we have recommended allows the market to work. Mutual fund fees are transparent and widely available in prospectuses, fund fact sheets, and reporting services, and the fees incurred by investors have declined significantly. Our latest research finds that mutual fund fees and expenses that investors paid fell to their lowest levels in more than a quarter century in 2006, continuing a trend observed since the early 1980's.<sup>30</sup> In short, mutual fund investors, and 401(k) investors, concentrate their assets into low-cost funds.

29 See "Rapid 401(k) Consolidation Shrinks Employer Options," *Employee Benefit News*, April 1, 2007; "Recordkeeper Consolidation Takes Center Stage," *Defined Contribution & Savings Plan Alert*, December 25, 2006; "401(k) Administration Rapidly Consolidating," *Money Management Executive*, December 11, 2006.

30 See Collins, *Fees and Expenses of Mutual Funds, 2006*, ICI Fundamentals, vol. 16, no. 2 (June 2007), available at <http://www.ici.org/pdf/fm-v16n2.pdf>. Office of Regulations and Interpretations Fee Disclosure RFI Page 17 of 19 In 2005, the average stock mutual fund had an expense ratio of 1.54%. But on an asset-weighted basis, the average expense ratio incurred by mutual fund investors in stock mutual funds was 0.91%. And the asset-weighted average expense ratio for 401(k) investors was even lower: 0.76%. Similar results can be seen in each broad type of stock fund, as well as in bond funds.<sup>31</sup> Several factors contribute to the relatively low average expense ratios incurred by 401(k) plan participants investing in mutual funds. Plan sponsors play a vital role in selecting and regularly evaluating the plan's investment line-up to ensure that each option's fees and expenses provide good value. Easy access to comparable and transparent mutual fund fee information helps employees in selecting investments for their accounts. The Pension Protection Act added a significant number of new notices that participants must receive, especially where the plan uses automatic enrollment and default investments. Some of these notices are under the jurisdiction of the Department while some are under the jurisdiction of the Department of Treasury and the Internal Revenue Service.<sup>32</sup> The Department should work with Treasury and IRS to consolidate these notices wherever possible. Sending a large number of discrete notices raises the risk that participants will stop paying attention to them. This will undermine rather than enhance transparency.

31 See *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, *supra* note 2.

32 The Internal Revenue Service has already issued some guidance regarding fee disclosure in the context of the notice required under section 402(f) of the Internal Revenue Code. See Notice 2007-7, Q&A-33. We strongly suggest the Department work with IRS in coordinating any fee disclosure requirements.

Office of Regulations and Interpretations Fee Disclosure RFI Page 18 of 19 19. Please identify any particularly cost-efficient (high-value but inexpensive) fee and expense disclosures to participants, and to the contrary any particularly cost-inefficient ones. Please provide any available estimates of the dollar costs or benefits of such disclosures. A high-value cost-effective disclosure regime would provide participants with streamlined, comparable information about investment products and any additional plan charges. This disclosure will address their need to make investment choices and periodically monitor their accounts. The Department should provide flexibility to plan sponsors and service providers on the format of disclosure. The Department should also allow electronic delivery and permit plan sponsors and service providers to leverage the Internet to make additional information on the options available electronically or in paper upon request. In contrast, two other approaches would be very cost inefficient. First, the Department should not require detailed disclosure to participants about service provider arrangements and costs, comparable to the information the employer receives. As we have discussed above, this information will not help the participant make proper account investment allocations, will impose unnecessary costs and could discourage employee participation in plans. The Department also should not require dollar amount disclosure of product fees attributable to an individual participant. Currently, this is not something the investment provider or recordkeeper can typically calculate, and it would be very expensive to design and implement systems and processes to produce this information. The SEC looked at this issue in the context of disclosure of mutual fund fees. A June 2000 General Accounting Office (now Government Accountability Office) report on mutual fund fees suggested various approaches to improving fee disclosure, one of which was to require that funds calculate and disclose to each fund investor the actual dollar amount of fund operating expenses attributable to that investor.<sup>33</sup> The SEC examined the GAO's report and concluded that the best way to improve shareholder understanding was to require a fee example in shareholder reports showing the expenses paid on each \$1,000 invested, based both on the fund's actual operating expenses and actual return for the period and, to allow comparisons among funds, based on an assumed return of 5 percent per year. <sup>34</sup> In its adopting release, the SEC cited Institute research concluding that the aggregate costs to survey respondents associated with calculating and disclosing individualized fund expenses would be 33 See General Accounting Office, "Mutual Fund Fees: Additional Disclosures Could Encourage Price Competition" (June 2000), available at <http://www.gao.gov/new.items/gg00126.pdf>. 34 See Securities and Exchange Commission, Final Rule, Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, 69 Fed. Reg. 11244 (March 9, 2004). Office of Regulations and Interpretations Fee Disclosure RFI Page 19 of 19 \$200.4 million in initial implementation and \$65 million in annual, ongoing costs.<sup>35</sup> This estimate covered only the costs for calculation and disclosure to retail investors. Providing this type of disclosure in 401(k) plans would be even more costly because a plan sponsor or recordkeeper must consolidate fee and account information with respect to each investment in a participant's account, information that derives from different sources. Current recordkeeping systems are not designed to receive the needed information from mutual fund companies and other financial product providers on a daily basis. If the Department believes that reducing asset-based charges into estimated dollar amounts is necessary for participants to understand adequately their fees, the Department should follow the model that accompanies the fee table in a mutual fund prospectus or the example in a fund's shareholder reports.<sup>36</sup> \* \* \* \* The mutual fund industry is committed to meaningful disclosure. Over the past 30 years, the Institute has supported efforts to improve the quality of information provided to plans and participants and the way in which that information is presented. We look forward to continuing to work with the Department. If you have any questions, please contact the undersigned at 202-326-5826 or Michael

Hadley at 202-326-5810. Sincerely, /s/ Mary Podesta Mary Podesta Senior Counsel – Pension Regulation and Acting General Counsel Attachment (ICI Board Policy Statement) 35

The Institute survey was conducted in 2000, and included responses from 39 mutual fund complexes with total net assets of \$4.8 trillion (approximately 77 percent of total industry net assets as of June 2000). 36 A mutual fund's prospectus provides a quantitative example showing the dollar amount of expenses an investor would pay on a hypothetical \$10,000 investment that earns 5 percent annually over 1-, 3-, 5- and 10-year periods. This calculation number takes into account any sales charges imposed by the fund. The fund's semi-annual and annual reports include a table showing the expenses paid on each \$1,000 invested, based both on the fund's actual operating expenses and actual return for the most recent six-month period and, to allow comparisons among funds, based on an assumed return of 5 percent per year. ICI Policy Statement Retirement Plan Disclosure Adopted by ICI's Board of Governors, January 30, 2007

In 2005, there were 47 million active participants in 401(k) plans, with their retirement savings invested not only in mutual funds but also a wide range of other investment products. As 401(k) plans assume increasing importance for future retirees, plan sponsors must be able to make the right choices in setting up their plans and participants must have the information necessary to make informed investment decisions. To that end, the Institute urges that the Department of Labor clarify the requirements for disclosure of the fees and expenses associated with 401(k) plans to assist plan sponsors in making meaningful comparisons of products and service providers. Similarly, we support action by the Department of Labor to require straightforward descriptions of all the investment options available to participants in self-directed plans. To achieve these important goals: The Department of Labor should require clear disclosure to employers that highlights the most pertinent information, including total plan costs. We believe required disclosure to employers should focus on the total fees paid by the plan to a service provider (in the form of a percentage or ratio) and how expenses are allocated between the sponsor and participants. Required disclosure also should address the various categories of expenses associated with a plan, including arrangements where a service provider receives some share of its revenue from a third party. Under ERISA, the obligation to provide this information should rest with those parties having a direct relationship with the employer. »

The Investment Company Institute (ICI) is the national association of the U.S. mutual fund industry, which manages more than half of 401(k) assets and advocates policies to make retirement savings more effective and secure. In the late 1990s, the Institute, in cooperation with other private-sector organizations, created a Model 401(k) Plan Fee Disclosure Form, which is posted on the Department of Labor website. More recently, the Institute also helped develop a list of service- and fee-related items that plan sponsors should discuss with potential providers. These tools serve to identify what services will be provided for the fees charged, show all forms of expenses, and help employers make meaningful comparisons among the products and services offered to the plan. The tools also can be useful to the Department in crafting regulations and other guidance. The Department of Labor should require that participants in all self-directed plans receive simple, straightforward explanations about each of the investment options available to them, including information on fees and expenses. In making investment elections under a plan, individuals should receive information on: investment objectives, principal risks, annual fees (expressed in a ratio or fee table), historical performance, and the investment adviser that manages the product's investments. The Department should expand the current disclosure requirements to require plan administrators to provide participants with a concise summary of these five key pieces of information for each investment option. One effective way to deliver this information is through email and other forms of electronic communication. Additional information, such as how fees and expenses are allocated among service providers, should

be made available to participants (for example, posted on the Internet). Such disclosure requirements would fill gaps in the information currently required to be provided to participants. The existing disclosure regime does not cover all plans in which participants make investment decisions for their accounts. For plans that are covered, participants must receive full information about mutual funds, in the form of the fund prospectus. For other products, important information – such as operating expenses and historical performance – is available only on request. We support revising current rules to require a summary document for all self-directed plans that provides, for each investment product, the type of information that investors value and use. This information will empower participants in self-directed plans to manage their accounts effectively. The mutual fund industry is committed to meaningful disclosure. Over the past 30 years, the Institute has supported efforts to improve the quality of information provided to plans and participants and the way in which that information is presented. Meaningful disclosure is critical to ensuring secure retirements for millions of Americans. » » » » » 2

## Appendix ICI's Record: 30 Years of Advocating Better Disclosure

The Institute has long acted both in conjunction with other organizations and on its own to enhance the ability of employers to make appropriate choices for their plans. The Institute also has consistently called for effective disclosure to plan participants about investment options. This appendix describes the Institute's efforts over time to improve disclosure for both plan sponsors and participants.

### Disclosure to Participants

For more than 30 years, the Institute has provided specific recommendations to the Department of Labor on the disclosure participants in self-directed plans should receive about investment options. Through letters and testimony before the Department and the ERISA Advisory Council, we recommended regulatory measures to ensure that participants and beneficiaries receive adequate information on which to base their investment decisions. In a 1976 letter to the Department, the Institute advocated that when an individual becomes a participant, he or she should receive complete, up-to-date information about plan investment options, and, thereafter, regular and current information as to his or her investments. In 1987, the Institute recommended that under then-proposed 404(c) regulations, participants should receive the kind of information included in a mutual fund prospectus or Statement of Additional Information for all investment options—not just investment options subject to federal securities laws. We repeated this suggestion in 2001 to the Department and in testimony in 2004 and 2006 before the ERISA Advisory Council. In 1992, the Institute recommended that where a 404(c) plan has a limited number of investment alternatives, plan fiduciaries should be required to provide sufficient investment information about each option up front. We urged the Department to specify the investment information that would be deemed sufficient, including information on fees and expenses and investment objectives. In testimony before the Department in 1997, the Institute asked the Department to address gaps in the disclosure regime, especially disclosure of administrative fees charged to participant accounts and information on annual operating expenses, which, for non-mutual fund investment vehicles, are required to be provided only upon request. In 1999, the Institute urged the Department to expand the scope of its proposed rules on electronic delivery to cover a broader range of disclosures and recipients. In testimony before the ERISA Advisory Council in 2004 and 2006, the Institute called for participants to receive clear and concise summaries of each investment option, including the product's investment objective, principal risks, fee/expense ratio (in the form of a fee table), and information about the investment adviser. In 2006, we added historical performance to the list. In the 2006 testimony, we also urged that this disclosure regime should apply to all self-directed plans—not just 404(c) plans—and that the Department update and expand its electronic disclosure rule in light of the increasing role of the Internet. » » » » » 3

### Disclosure to Plan Sponsors

The Institute likewise has consistently advocated clear rules for disclosure to plan sponsors and has developed

various tools for use by sponsors and service providers. In 1999, the Institute published a Uniform 401(k) Plan Fee Disclosure Form, developed jointly with the American Bankers Association (ABA) and American Council of Life Insurance (ACLI). The form, which the Department posted on its website, is designed to help employers identify and monitor 401(k) plan fees and expenses and compare the fees and services of different providers. In testimony before the ERISA Advisory Council in 2004, the Institute called for clear, meaningful, and effective disclosure to plan sponsors. We recommended that plan sponsors be required to obtain complete information about investment options before adding them to the plan menu and obtain information concerning arrangements where a service provider receives some share of its revenue from a third party. The Institute offered to organize a task force to assist the Department in developing a disclosure regime for these compensation arrangements. In 2005, the Institute published a Model Disclosure Schedule for Plan Sponsors that might be used to disclose information on receipt by service providers of revenue from unaffiliated parties in connection with services to a plan. The Institute began discussions with other trade associations on developing an appropriate disclosure regime. In 2006, the Institute published a 401(k) plan fee and expense reference tool, developed jointly with the ACLI, ABA, Securities Industry Association, and American Benefits Council. The tool is a list of fee and expense data elements that plan sponsors and service providers may want to discuss when entering into service arrangements. We have asked the Department to post the tool on its website. » » » » 1401 H Street, NW Washington, DC 20005 202/326-5800 [www.ici.org](http://www.ici.org) Copyright © 2007 by the Investment Company Institute

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