

**Testimony of
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for

**“Hearing on Reasonable Contracts or
Arrangements Under Section
408(b)(2) - Fee Disclosure”**

before the

**United States Department of Labor
Employee Benefits Security Administration
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Good afternoon. My name is Matthew Hutcheson. I serve as an independent ERISA 3(21) fiduciary. Thank you for the opportunity to testify today.

American workers who participate in qualified retirement plans are not being adequately protected – but easily could be.

Currently, Plan decision-makers, whether plan sponsors or participants, have no way of knowing – much less understanding – the “crazy-quilt” of costs embedded in their retirement plans.

I want to speak today on behalf of the millions of plan participants who trust that we will finally enable fiduciaries of qualified retirement plans to discharge their duties *solely in the interest* of plan participants *and beneficiaries* for the *exclusive purpose* of providing benefits.

Things are different now than they were thirty-five years ago, when ERISA became law. The recent Supreme Court decision in *LaRue v. DeWolff*, casts a sobering light on today’s reality. Accounts are now predominantly under the control of participants, who have become decision makers with respect to plan assets. So disclosure to participants has never been more necessary. Their decisions impact the retirement income security not only of themselves, but their beneficiaries as well; and ERISA has always afforded equal protections to beneficiaries.

If decision makers, whether named fiduciaries or simply those with discretion with respect to plan assets or operations, lack possession and understanding of plan costs, they cannot judge whether any such cost is reasonable.

Most providers of investment products and plan services claim they have no duty to disclose costs to decision makers. Yet decision makers have a duty to know and understand those costs. In a vacuum of information, prudent decision makers cannot assume that the cost of any service is reasonable, and therefore cannot comply with ERISA’s “sole interest” and “exclusive purpose” rules established for the protection of plan participants and their beneficiaries.

When all relevant information is available to buyers and sellers of products and services, and they freely agree to an exchange of value, then it is safe to judge that the cost reflected in the transaction is fair and reasonable. In those circumstances decisions can be made in the sole interest of participants.

The simple solution I offer today is a method of disclosing all costs in an easy to understand format. It enables decision-makers to judge prudently whether plan costs are reasonable in relation to services provided.

The Five Elements of Disclosure

There are five necessary elements of full and fair disclosure.

1. First, the disclosure of gross and net returns expressed in dollars.
2. Second, the disclosure of net rates of return for each fund at both the plan and participant level, expressed in percentages.
3. Third, a comparison of the net returns for the account or plan as a whole against a standard index that reflects the net rate of return that any participant or plan could have achieved through a broadly diversified market-tracking portfolio.
4. Fourth, a standard report format.
5. Fifth, the disclosure of conflicts of interest if any.

Let me lay out each of these elements in a little more detail.

Element 1

The difference between gross and net returns is equal to the total costs for any period. By disclosing gross and net returns, with a breakdown between investment and administrative costs causing the gap between the two, any decision maker can, at a glance, quickly compare the costs for the given services.

The details from which the total investment and administrative costs are derived should also be available to any decision-maker upon request. Cost details should be delivered in a timely and complete manner. Generally, costs are immediately known by those charging them, and could easily be provided to decision makers within 20 days following the end of a reporting period.

We should avoid a system of “definition dependent” disclosure that allows providers to coin new terms or implement new techniques that circumvent the intent of regulations. We see this very game being played now in the case of “revenue sharing” because it, by name, was not specifically defined in the statute.

Let’s face it: providers of financial services will always try to be at least one step ahead of the regulators. They can hide costs faster than legislators or regulators can find them. Any method other than gross-to-net disclosure simply prolongs the game of blind-man’s bluff that has gone on too long.

This simple gross-to-net disclosure method catches all fees, and arms decision makers with sufficient information and understanding to assess the reasonableness of the costs of operating or participating in the plan. It ends the opportunity and temptation to hide costs once and for all.

Element 2

The second element is to disclose true net rates of return expressed as percentages on a fund-by-fund basis. True net rates of return mean the returns for a specific plan or participant account for the relevant period. By contrast, fund-level rates of return are generally not helpful because those do not capture costs incurred at the plan level, or more importantly, at the participant level. This element reveals the effects of participant choices in fund selection, and also captures costs incurred at an individual level--for instance, when a participant is charged for borrowing against his or her account balance.

Element 3

The third element provides context and meaning for disclosure, by contrasting real net returns with what “could have been” had the plan or participant invested in the broad market through a low-cost portfolio. This third element of disclosure is not just another benchmarking scheme. Decision makers are regularly told that more and/or better services equate into better net returns despite the added costs. Sponsors and participants have a right to know the bottom-line results regarding the relationship between costs and performance. Establishing a broad, market-tracking point of comparison enables decision makers to determine whether the net performance of a plan justifies its costs. Underperforming the index reveals that there are easily-avoided problems with poor portfolio construction, excess costs, or both. It enables decision makers to correct those problems to enhance future retirement income security.

Element 4

The fourth element standardizes reporting. Uniform disclosure enables fiduciaries and participants to compare investments within a plan, and one service provider against another. Appendix A reflects the method of disclosure that, when delivered promptly to decision makers, will enable them to make prudent choices regarding services in serving the best interests of participants. The format for disclosure accurately summarizes historical information in a manner that is easily understood by decision makers with varying levels of expertise, and therefore is useful in making decisions that benefit the plan and its individual participants.

Element 5

The fifth element is disclosure of conflicts of interests. A detailed statement that clearly discloses the names of the individuals or entities whose interests are, or could potentially be, adverse to the interests of the plan or the interests of its participants is essential. It should contain facts, circumstances, and other written explanations and clarifications. For example, revenue sharing--including its amount and purpose--should be disclosed in this statement. Disclosing revenue sharing, and other subsidies between service providers, enables lay fiduciaries to become aware of issues they may not have considered otherwise, thus enabling them to properly discharge their duties. While all

costs, including revenue sharing, are disclosed by the gross-to-net approach described in element one, the costs associated with conflicts of interest should be individually disclosed.

Conclusion

This hearing today is not about the well-being of providers of financial services. Nor is it about the well-being of trade associations that represent such providers. Nor is it about the well-being of independent fiduciaries like me.

It is about protecting the interests of plan participants by adequately disclosing to them the costs associated with the operation of their plan. The five elements of full and fair disclosure help decision makers understand and control costs, and thereby and protect the retirement income security of plan participants and their beneficiaries.

Thank you.

APPENDIX A

A	B	C	D	E	F	G	H	I	J
<u>Fund</u>	<u>Beginning Balance</u>	<u>Total Contributions</u>	<u>Withdrawals & Disbursements</u>	<u>Transfers</u>	<u>Gross Earnings</u>	<u>Investment Expenses</u>	<u>Admin. Expenses</u>	<u>Ending Balance</u>	<u>Net Return</u>
ABC Stock	\$ 9,562.12	\$ 3,000.00	-	-	\$ 989.20	(\$192.16)	(\$106.47)	\$ 13,252.69	6.24%
XYZ Bond	1,588.00	500.00	-	-	61.92	(\$20.23)	(\$11.21)	2,118.48	1.66%
Stable Value	3,447.22	1,000.00	-	-	157.43	(\$64.30)	(\$35.63)	4,504.72	1.46%
Annuity	4,001.99	1,500.00	-	-	138.31	(\$96.95)	(\$53.72)	5,489.63	-0.26%
Total	\$ 18,599.33	\$ 6,000.00	-	-	\$1,346.86	(\$373.64)	(\$207.03)	\$ 25,365.52	3.55%
Fee & Expense Summary (Columns G & H)									
				1. Investment costs:	\$ (373.64)	1.73%			
				2. Administrative costs:	\$ (207.03)	0.96%			
				Total costs:	\$ (580.67)	2.69%			
Excess (Costs) or Returns									
				Your net return	3.55%				
				Your personal index	5.35%				
				Your excess (costs) or returns	(1.80%)				

Explanation of column headings, A through J:

Column:

- A. Fund – The name of the investment, whether mutual funds, ETF’s, Annuities, Employer Stock, Collective Trusts, Pooled Separate Accounts, etc.
- B. Beginning Balance – Reconciled from prior period’s ending balance. Beginning and ending balances “are what they are.” In other words, they must tie to the actual values of the investments themselves, as reported by the fund/financial institutions. Beginning and ending balances are known and currently tracked by record keepers as a matter of practice.
- C. Total Contributions – Known and tracked by record keeper.
- D. Withdrawals & Disbursements – Known and tracked by record keeper.
- E. Transfers – Movements between funds; known and tracked by record keeper.
- F. Gross Earnings – Calculated. The ending balance is always known by the record keeper at the end of each valuation period. Since all of the other elements that account for the difference between beginning and ending balances are known, the only remaining item is gross earnings, which can be calculated with simple addition and subtraction. The alternative—calculating the gross returns for each fund and participant—would, as the financial industry has stated, be prohibitively complicated and expensive, and would require the financial industry to disclose

“gross returns” to a record keeper. We get to the same number this way, and since it is simple arithmetic, it will not cost more than a few hours of programming for record keeping systems.

- G. Investment Fees & Expenses – The sum of investment expenses. Investment expenses include the actual expense ratio reported by investment firms on the investment product’s financial statement, other fees (i.e. redemption fees, contract charges, etc.), plus brokerage commissions and costs to clear the trades, investment advice and agent commissions, custodial, and miscellaneous investment product fees/charges.
- H. Administrative Fees & Expenses – The sum of administration and other operational expenses. Administration expenses paid by plan assets are already accounted for by the record keepers. It can include, but is not limited to, record keeping, compliance testing, reporting, consulting, legal, accounting, auditing, or other non-investment specific fees paid directly from plan assets.
- I. Ending Balance – Calculated by adding columns A through H.
- J. Net Return – Derived using standard guidelines for the calculation of investment returns and in common use currently. (For purposes of illustration, net returns in this sample statement are calculated simply by dividing Gross Earnings less Fees & Expenses [numerator] by the beginning balance plus one-half the net contributions [denominator]. In an actual statement, the calculation of net investment returns would be determined using more precise methods that take into account the dates and amounts of actual cash flows.)