THE
SPARK
Institute, Inc.

Testimony of

Larry H. Goldbrum, Esq.

General Counsel, The SPARK Institute

Before the

UNITED STATES HOUSE OF REPRESENTATIVES

SUBCOMMITTEE

on

HEALTH, EDUCATION, LABOR and PENSIONS

Regarding

"401(k) Fair Disclosure for Retirement Security Act of 2009"

April 22, 2009

Chairman Andrews, Ranking Member Kline, honorable members of the Committee, my name is Larry Goldbrum and I am General Counsel of The SPARK Institute, an industry association that represents the interests of a broad based cross section of retirement plan service providers, including record keepers and investment managers who will be affected by the proposed 401(k) Fair Disclosure for Retirement Security Act of 2009 (the "Bill"). Our members include most of the largest service providers in the retirement plan industry and collectively they service more than 62 million defined contribution plan participants. It is an honor for me to share our organization's views on the proposed legislation. I welcome the opportunity to respond to your questions after my opening statement.

INTRODUCTION

The SPARK Institute supports and encourages fee transparency that helps plan sponsors and participants understand the fees and expenses that they pay for plan and investment services, and make decisions on a fully informed basis. We commend the Committee for its efforts in this area. Our goal today and hopefully in future collaborative efforts is to ensure that the approach taken in any legislation has a meaningful impact on plan participants and sponsors ability to understand 401(k) fees and does not unintentionally drive those fees up.

The SPARK Institute believes that America's employer-sponsored retirement plan system is a fundamentally proven, sound, competitive and innovative system that:

- Provides the best way for American workers to save and invest to reach their retirement goals, and
- Provides valuable services and **good value** for the cost.

Fee disclosure should be a part of an overall assessment made by plan sponsors and participants about the value they receive for the cost. In addition to fees, plan sponsors and participants must evaluate investment performance and the quality and utility of the services provided. Ultimately, the best approach to fee disclosure will be one that is flexible, concept-based and allows service providers and plan sponsors to tailor disclosures with comparable information for each plan investment option. This measured approach will avoid overwhelming participants with extensive detail and will help them understand the fees they are paying and the services they are receiving in return. If we are not careful, however, requirements intended to help participants could instead increase costs and create potential fertile ground for lawsuits against plan sponsors without helping participants make informed choices.

Many misperceptions and misunderstandings have emerged in the discussions about plan fees and their disclosure. I would like to try to correct some of those misperceptions today. In addition, while we have not had sufficient time in advance of this hearing to review the specifics of the proposed legislation, we would like to address certain provisions that we anticipated may be included.

MISPERCEPTIONS ABOUT THE RETIREMENT PLAN INDUSTRY

The SPARK Institute recently completed a series of white papers entitled “The Case for Employer-Sponsored Retirement Plans” analyzing certain aspects of the retirement plan industry including “Fees and Expenses”, “Benefits and Accomplishments” and “Coverage, Participation and Retirement Security.” These reports identify some important facts and dispel many myths about employer-sponsored retirement plans, particularly 401(k) plans.

Some common misconceptions are that 401(k) plans are not a "good value" for workers trying to save for retirement, and that the fees for plan and investment services do little more than erode workers’ retirement savings. These criticism do not take into account all of the services that are provided to the plan sponsor and participants, including investment management. In fact, the data shows that plan participants receive more services and support and have more flexibility when investing through their 401(k) plans than they would if saving through retail IRAs. In addition, 401(k) plan participants may also benefit from sponsor-paid services, matching and profit-sharing contributions, and group pricing. And finally, recent studies show that on average, expenses for 401(k) participants are lower than the expenses paid by retail mutual fund investors.

There is also a misperception that service providers make too much money at the expense of American workers. Providing 401(k) plan services is capital and labor intensive and involves substantial start-up and maintenance expenses, especially in light of the ever-changing employee benefit legislative and regulatory environment. In fact, cost pressures are significant because competition is fierce. The industry has been consolidating over the past ten years as many providers were unable to maintain profitability. SPARK Institute data indicates that more than 60 companies have sold their businesses in the past five years, and more than 20 additional firms exited the record keeping side of the business during that period by outsourcing that function to third party service providers. The industry's pre-tax profit margin averaged 21% from 2005 through 2007, a period when the Dow Jones Industrial average was between approximately 10,800 and 13,400. However, the 2008 average pre-tax profit margin is estimated to be approximately 10%, and in negative territory for 2009, because of the market collapse.

Another myth is that plan sponsors and workers do not understand the fees and expenses associated with their retirement plans because the information is not being adequately disclosed, or is not available. The vast majority of retirement plan and investment providers provide substantial, detailed and understandable information about plan fees and expenses to plan sponsors and participants above and beyond what is already required by law because they recognize that it makes good business sense to do so. It also helps them avoid potential misunderstandings and claims from plan sponsors, plan participants and regulators. In fact, a strong case can be made that it is a combination of simple human nature and the "do it for me" preferences of a significant number of American workers when it comes to retirement saving and investing -- rather than the lack of information -- that is at the root of any lack of understanding. As these issues are considered, it is crucial that we all understand that plan sponsors and participants already receive and have access to a lot of information about plan fees, and that additional disclosures must be more useful, not just more information.

DISCUSSION OF SPECIFIC PROPOSALS

Before I begin my comments about the specifics of the proposed Bill, I want to note that retirement plan and investment providers are already regulated by various agencies including the IRS, DOL, SEC, OCC, FINRA, and state insurance and securities regulators. Having multiple disclosure standards makes compliance very expensive and adds to the fees paid by plans and participants. The SPARK Institute supports a coordinated approach to regulating fee disclosure for retirement plans.

The proposed Bill requires that all service providers make detailed disclosures about plan fees and expenses in four categories. The SPARK Institute strongly urges the Committee to reconsider whether requiring disclosure to be made through a "one size fits all" solution using pre-determined categories is appropriate. Not all fees fit neatly into categories and no single form or methodology can adequately address the diversity of products and service structures without favoring one segment of the industry over others. Any statutory framework must be flexible and adaptable to the broad array of investment products and service structures, and must be able to accommodate the competitive and ever changing nature of the retirement plan and investment industries.

A. Disclosure to Plan Sponsors

With regard to disclosures to plan sponsors, service providers should not be required to calculate the actual dollar amount of fees and expenses, particularly those that are embedded in the expense ratios of plan investment options. Providing expense ratio or rate information, instead of dollar estimates, will provide enough information. Service providers can, upon request, provide simple estimates of the aggregate amounts of such fees and expenses based on certain assumptions and average account data.

Much has been made of the debate over disclosure of fees in "bundled" vs. "unbundled" service structures. Unbundled providers argue that their products and services may appear to be more expensive to plan sponsors when compared to the same or comparable services that are offered through a bundled service provider. Bundled service providers argue that they may not offer component services on an unbundled basis, and do not have unbundled pricing or cost information available. Bundled providers add that any such unbundled pricing information is inherently arbitrary, hypothetical, unreliable, and potentially misleading. The SPARK Institute views this debate as a distraction from the real issue – the need to provide useful and relevant disclosures to enable plan sponsors to make sound fiduciary decisions. Plan sponsors will have their own preferences toward either bundled or unbundled product offerings, and have the ability and right to request information that they deem necessary in order to evaluate service providers. Similarly, service providers should have the ability to structure their products and services on an unbundled or bundled basis and price their products and services as they choose.

Plan sponsors have the ability to request information from service providers and service providers have the option to comply with such requests in the hopes of winning new or retaining existing business. Market forces, industry best practices, the threat of litigation, and the threat of regulatory enforcement actions should drive industry behavior instead of legislative mandates. The SPARK Institute believes that ultimately the bundled versus unbundled disclosure debate is more about companies with different product structures, service models, product and service capabilities, and pricing structures debating about market forces and competition than alleged defects in disclosure of employer-sponsored retirement plan fees. The SPARK Institute does not believe that new laws and regulations should attempt to resolve this business debate.

B. Disclosure to Plan Participants

SPARK Institute members stand ready to assist plan sponsors in providing fee information to plan participants. As with service provider disclosure to plan sponsors, The SPARK Institute urges the Committee to seek a flexible and concept based framework, as workers will ultimately bear the costs of additional disclosures.

Instead of creating such a framework, the Bill anticipates an omnibus notice and fee chart addressing all the plan's investment options. The Bill's requirement that the fee chart categorize charges relating to plan investment options has the unintended effect of increasing burdens and costs without providing new or more useful data to participants. Categorizing fees by the way they are charged, which may have nothing to do with what they are for, will not help participants better understand them. With respect to a plan's investment options, participants should instead be provided with information regarding the total investment fees (e.g., the expense ratio) and the transaction related fees (e.g., redemption fees). Providing participants with extra detail about how fees are broken down will likely confuse or overwhelm them instead of enlightening them.

The Bill also obligates the plan sponsor to provide dollar basis disclosures or estimates of indirect charges, such as fees that are embedded in investment products, for each participant on quarterly benefits statements. These charges, by definition, are embedded in the funds and the information needed for the calculations and estimates does not exist on the record keeping systems that produce the statements. Moreover, since the fund and account information is reported net of the embedded fees, adding this information to the statements will result in information that does not add up or make sense.

C. <u>Other Requirements</u>

It is our understanding that the proposal also includes a requirement that conditions ERISA 404(c) fiduciary liability protection on the inclusion of an index fund that meets certain subjective requirements. In our opinion, this precondition is effectively the same as a mandate, which is unprecedented under ERISA. The Bill's objective – increased transparency – does not warrant a specific fund requirement. We are also very concerned about the subjective nature of the fund description which requires the use of "an appropriate broad-based securities market index fund and which offers a combination of historical returns, risk and fees that is likely to meet the retirement income needs at adequate levels of contribution." Reasonable investment experts are likely to disagree on which funds satisfy such requirements. Additionally, as we have all been painfully reminded in recent months, past performance is no guarantee of future results. The subjective nature of the requirement makes it untenable and exposes plan sponsors to unnecessarily increased litigation risk. And finally, mandating the use of index funds as a potential "low cost" investment option as a way of reducing plan costs relies on the misconception that doing so will change the economics of servicing a plan. Regardless of which funds are used in a plan, plan service providers must have a source of revenue for the total package of services they provide.

<u>CONCLUSION</u>

On behalf of The SPARK Institute, I thank the panel for the opportunity to share our views on these important issues, and I welcome your questions.