



**TESTIMONY OF  
ROBERT G. CHAMBERS**

**ON BEHALF OF**

**AMERICAN BENEFITS COUNCIL**

**BEFORE THE**

**U.S. HOUSE OF REPRESENTATIVES  
EDUCATION AND LABOR COMMITTEE**

**IN THE HEARING ENTITLED**

**"ARE HIDDEN 401(K) FEES UNDERMINING RETIREMENT SECURITY?"**

**TUESDAY, MARCH 6, 2007**

My name is Robert G. Chambers and I am a partner in the Charlotte, North Carolina law firm of Helms Mulliss & Wicker. I have advised clients with respect to 401(k) plan issues since 401(k) was added to the Internal Revenue Code in 1978. In that regard, my clients have included both major employers that sponsor 401(k) plans as well as national financial institutions that provide services to 401(k) plans.

I am also chair of the board of the American Benefits Council (“Council”) on whose behalf I am testifying today. The Council’s members are primarily major U.S. employers that provide employee benefits to active and retired workers and that do business in most if not all states. The Council’s membership also includes organizations that provide services to employers of all sizes regarding their employee benefit programs. Collectively, the Council’s members either directly sponsor or provide services to retirement and health benefit plans covering more than 100 million Americans.

The Council very much appreciates the opportunity to present testimony with respect to 401(k) plan fees. With the decline of the defined benefit plan system, 401(k) plans have become the primary retirement plan for millions of Americans. Accordingly, it is more important than ever for all of us to take appropriate steps to ensure that 401(k) plans provide those Americans with retirement security. In that regard, our goal is an effective and fair 401(k) system that functions in a transparent manner and provides meaningful benefits at a fair price in terms of fees.

### **We Support Enhanced Disclosure And Reporting Requirements.**

With respect to 401(k) plan fees, we believe that this Committee would be pleased by what our member companies are doing. Our members - - both plan sponsors and service providers - - report to us that plan fiduciaries are taking extensive steps to ensure that fee levels are fair and reasonable for their participants. Plan fiduciaries are asking hard questions regarding the various plan services and fees, and the fiduciaries are obtaining answers that give them the tools to negotiate effectively for lower fees and to provide meaningful information to participants. In the case of small plans with less bargaining power, plan fiduciaries are using additional fee information to shop more effectively for service providers.

Are there exceptions to this rosy picture? Of course there are. No system functions perfectly. So we need to strive to make the system even better. How can we achieve those improvements? The answer is conceptually simple: through even more universal disclosure of meaningful information. We need to ensure that all plan fiduciaries and service providers follow the practices we are hearing about from our members. Those practices include disclosure to plan fiduciaries of direct and indirect fees that service providers receive from the plan or from unrelated third parties. Those practices also include clear, meaningful disclosure to participants.

In this regard, we commend the Department of Labor and the Government Accountability Office (“GAO”). The Department of Labor has been working on a three-part project to enhance transparency that is conceptually the same as the enhanced regime we are recommending. This three-part approach is very similar to the recommendations made by GAO. One part would require the type of disclosure by service providers to plan fiduciaries that I refer to above. A second part would require clear, meaningful disclosure to participants. And a third part would require plans to report fee information to the Department. We have concerns regarding certain specific points with respect to the Department’s proposals, but conceptually we are in agreement with the general approach. We look forward to a constructive dialogue with the Department as its proposals move forward.

As described in its letter to GAO regarding plan fees, the Department of Labor has already taken a number of steps to improve awareness and understanding with respect to plan fees. The Department makes available on its website important materials designed to help participants and plan fiduciaries understand plan fees. These materials include “A Look at 401(k) Plan Fees for Employees”, which is designed to assist participants in selecting investment options. For employers and other plan fiduciaries, the Department makes available “Understanding Retirement Plan Fees and Expenses”, “Tips for Selecting and Monitoring Service Providers for Your Employee Benefit Plan”, and “Selecting and Monitoring Pension Consultants – Tips for Plan Fiduciaries”. In addition, the Department makes available a model form - - called the “401(k) Plan Fee Disclosure Form” - - that is designed to facilitate the disclosure of plan fees by service providers to plan fiduciaries and the comparison of these fees. Finally, the Department has been conducting educational programs across the country that are designed to educate plan fiduciaries about their duties.

In short, we believe that the Department of Labor and GAO are making, and have been making, important contributions to improving the 401(k) plan system. In this regard, we are also proud of our own efforts to improve fee disclosure, which include working in a constructive manner with the Department to help it improve disclosure and transparency. For example, recently, a group of associations submitted to the Department of Labor an extensive list of fee and expense data elements that plan sponsors can use to discuss fees effectively with their service providers. (The associations were the American Benefits Council, the Investment Company Institute, the American Council of Life Insurers, the American Bankers Association, and the Securities Industry Association (now the Securities Industry and Financial Markets Association).) We view disclosure enhancement as a critical part of our mission to strengthen the 401(k) plan system and we are committed to continuing to offer our help to this Committee, other Committees, and the agencies.

### **Addressing Concerns And Questions.**

So far, I have been talking about positive things that can be done to improve the 401(k) plan system. Now I would like to touch on concerns that I know are shared by this Committee and answer some questions that have been raised.

### **We Must Not Undermine The Voluntary System.**

The success of the 401(k) plan system is dependent on many things, including very notably the willingness of employers to offer these plans and the willingness of employees to participate in the plans. It is critical that any reform efforts not inadvertently undermine these key building blocks of our system. Clear, meaningful disclosure is needed; overly complicated and burdensome disclosures would only push employers and service providers away from the 401(k) plan system. In particular, burdensome rules would be yet another powerful disincentive for small employers to maintain plans. Overly complicated disclosure would also confuse rather than inform participants; participants need clear meaningful information that is relevant to their decision-making.

In addition, employee confidence is critical to their participation in the system. If the huge number of employees participating in well-run efficient 401(k) plans hear only about the 401(k) plan problems and do not hear about the strengths of the system, their confidence will be eroded, their participation will decline, and their retirement security will be undermined.

### **We Must Not Inadvertently Increase Fees In The Effort To Reduce Them.**

Every new requirement imposed on the 401(k) plan system has a cost. And generally it is participants who bear that cost. So it would be unfortunate and counterproductive if a plethora of new complicated rules are added in an effort to reduce costs, but the expense of administering those new rules actually ends up adding to those costs. The Department of Labor has explicitly raised this exact concern. In its letter to GAO regarding the GAO plan fee report, the Department noted that its own fee disclosure project must be designed “without imposing undue compliance costs, given that any such costs are likely to be charged against the individual accounts of participants and affect their retirement savings.”

In this regard, it is important to recognize a key point noted in the GAO report. In the course of numerous plan fee investigations conducted by the Department of Labor in the late 1990's, no ERISA violations were found with respect to 401(k) plan fees. Moreover, the Department of Labor receives enforcement referrals from various entities, such as federal and state agencies. The GAO report notes that “only one of the referrals that the [Department of Labor] has closed over the past 5 years was directly

related to fees” (emphasis added). In the context of these facts, imposing burdensome new rules and costs to be borne by participants would be even less justified.

### **Fees Can Only Be Evaluated In The Context Of The Services They Pay For.**

Another critical point to bear in mind is that we must not examine fee amounts out of context. Any specific fee can only be effectively evaluated in the context of the quality of the service or product that is being paid for. For example, some actively managed investment options may logically have higher than average expenses, but it is the net performance of the option that is critical to retirement plan sponsors and participants, not the fee component in isolation. We must avoid studying fees in a vacuum. Fees are very important, but they are only one component of performance; with respect to investments, other key components include minimization of risk, diversification, relative peer group performance, quality of the investment organization, and, of course, investment return. Our objective should be excellent performance and service at a fair price.

Another example of this point is that increased fees generally reflect increased services. In the past several decades, there has been enormous progress in the development of services and products available to defined contribution plans (“DC plans”) such as 401(k) plans. For example, many years ago, plan assets generally were valued once per quarter - - or even once per year - - so that employees’ accounts were generally not valued at the current market value. Participants generally were not permitted to invest their assets in accordance with their own objectives; the plan fiduciary generally invested all plan assets together. Today, 401(k) plans generally value plan investments on a daily basis, and permit participants to make investment exchanges frequently (often on a daily basis) to achieve their own objectives. Other new services include, for example, internet access and voice response systems, on-line distribution and loan modeling, on-line calculators for comparing deferral options, and investment advice and/or education services.

In addition, the legal environment for DC plans used to be simpler, with far fewer legal requirements and design options. New legal requirements or options can require significant systems enhancements. For example, system modifications were needed to address catch-up contributions, automatic rollovers of distributions between \$1,000 and \$5,000, Roth 401(k) options, redemption fees and required holding periods with respect to plan investment options, employer stock diversification requirements, default investment notices, automatic enrollment, and new benefit statement rules. Today, 401(k) plans have become the dominant retirement vehicle for millions of American workers. With this change has come the need to help participants adequately plan for their retirement. Service providers have responded by developing investment advice offerings, retirement planning and education, programs to increase employee

participation in plans, and plan distribution options that address a participant's risk of outliving his or her retirement savings.

Naturally, the new services and products and the needed systems modifications have a cost. In this regard, we also want to emphasize that the disclosure rules need to be flexible enough to take into account the ever evolving 401(k) plan service market. For example, the rules need to be consistent with the current trend toward reducing the size of the plan investment menu as well as the trend toward offering a brokerage account option.

On a related point, we see enhanced plan fee disclosure as another important step with respect to participant education. And we look forward to working with this Committee on further participant education initiatives.

### **Why Do Fee Levels Differ So Much Among Different Plans?**

Different workforces need different services. Accordingly, the 401(k) plan market has attracted a number of different service providers that have developed numerous service options for plans, often with different fee structures and different services available for separate fees. This structure avoids forcing plans to pay for services that they do not want or use, and increases the options available to plan sponsors wishing to find providers and services that meet their and their employees' unique needs.

Concerns have been raised about the higher level of fees for smaller plans. Many plan fees vary only slightly (if at all) based on the number of participants in the plan. Accordingly, on a per-participant basis, plan costs can be much higher for small plans than for large plans. On a similar point, many costs do not vary with the size of a participant's account, so plans with small accounts will often pay much higher fees - - on a percentage of assets basis - - than plans with large accounts. These effects are most often a function of the nature of the services rendered: for example, plans must meet the same regulatory requirements without regard to whether a plan has 100 participants or 100,000 participants, and without regard to whether the average account size is \$5,000 or \$50,000.

### **Who Pays DC Plan Fees?**

By law, the employer must pay certain fees, such as the cost of designing a plan. But there are a wide range of fees that are permitted to be paid by the plan and its participants, such as fees for investments (which generally constitute the vast majority of a plan's total fees), recordkeeping, trustee services, participant communications, investment advice or education, plan loans, compliance testing, and plan audits. Many employers voluntarily pay for certain expenses that could be charged to the plan and its

participants, such as recordkeeping, administrative, auditing, and certain legal expenses. On the other hand, investment expenses, such as expenses of a particular mutual fund or other investment option, are generally borne by the participant whose account is invested in the fund.

### **Why Does One Service Provider Sometimes Receive Fees From Another Service Provider? Is This “Revenue Sharing”? Is This A Problem Area?**

Some maintain that “revenue sharing” is wrong and should be prohibited. That view reflects a misunderstanding of how the 401(k) plan system works. Let me explain.

It is not uncommon, for example, for mutual funds or other investment options to pay other plan service providers for services needed by the funds. For example, assume that participants of a plan invest some of their assets in Mutual Fund A. If these were retail investors in Mutual Fund A, Fund A would need to: maintain separate accounts for each investor; provide a means for investors to interact with Fund A (e.g., internet access, voice response systems, telephone service representatives); make certain that investors receive statements, investment confirmations, and any statutory notices; and prepare the appropriate tax reporting for any distributions. When a participant invests in Fund A through a retirement plan, the plan’s recordkeeper generally assumes these responsibilities and bears the cost of performing them. It is not uncommon for Fund A to pay the plan’s recordkeeper for performing the services that the fund would otherwise have to perform in the retail environment.

Such “inter-service provider” fees arise because different service providers cooperate in providing a total service package to a plan. “Revenue sharing” is the term often used to describe these types of inter-service provider fees. In fact, fund companies typically designate a portion of their overall expense ratio as “shareholder servicing fees”, and it is this expense stream that is typically used to pay other providers.

There is nothing inherently problematic regarding inter-service provider fees and the current-law prohibited transaction rules preclude inter-service provider arrangements that would create conflicts of interest. For example, assume that a plan pays Mutual Fund A \$100 for investment services and the plan pays unrelated Service Provider B \$50 for recordkeeping services. Assume further that Mutual Fund A pays Service Provider B \$10 to provide shareholder services so that A receives \$90 net and B receives a total of \$60. Assume further that B discloses the receipt of the extra \$10 to the plan fiduciary so that the plan fiduciary can evaluate the fee and the relationship between Mutual Fund A and Service Provider B. If \$100 is a fair price for investment services, why does it matter whether A performs shareholder servicing itself or subcontracts with Service Provider B to perform those services? In other words, if Mutual Fund A performed the services itself, the cost to the plan would be the same

\$150, but A would keep the full \$100, instead of paying \$10 of its \$100 fee to B. And if \$50 is a fair price for recordkeeping services provided to the plan, why does it matter if B receives an additional \$10 for services rendered to A? This example illustrates how an efficient subcontracting relationship works among service providers.

We are not suggesting that disclosure of the inter-service provider fees is not important. On the contrary, as discussed previously, we are very supportive of such disclosure. But the existence of these arrangements is not indicative of an inherent problem or a sign that 401(k) participants are paying excessive fees. If fully disclosed, these subcontracting arrangements can, on the contrary, be quite efficient and the current-law prohibited transaction rules are already in place to preclude conflicts of interest.

### **Are Plan Fees Too High?**

Competition among investment options and service providers is intense, which exerts downward pressure on fee levels. For example, as noted above, investment expenses are generally the largest plan expense. These expenses are reviewed in the context of reviewing the performance of investment options. Plans routinely review such performance: a 2006 survey by the Profit Sharing/401(k) Council of America indicates that 62% of plans review plan investments at least quarterly and substantially all plans conduct such a review at least annually.

In fact, plan investment fees are much lower than fees outside the context of plans. For example, a 2006 study by the Investment Company Institute found that in 2005 the average asset-weighted expense ratio for 401(k) plans investing in stock mutual funds was .76%, compared to a .91% average for all stock mutual funds.

### **Conclusion.**

We are very supportive of enhanced disclosure of plan fees. But fee disclosure must be addressed in a way that does not undermine participant confidence in the retirement system and does not create new costs that have the counterproductive effect of increasing fees borne by participants. We are committed to working with the government to make improvements in the fee disclosure area, including reporting to the Department of Labor. We believe that the best approach to the fee issue is through simple, clear disclosures that enable plan sponsors and participants to understand and compare fees in the context of the services and benefits being offered under the plan.