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NATIONAL ASSOCIATION OF MANUFACTURERS

THE ERISA INDUSTRY COMMITTEE

AND

UNITED STATES CHAMBER OF COMMERCE

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON WAYS AND MEANS

IN THE HEARING ON THE APPROPRIATENESS OF RETIREMENT PLAN FEES

OCTOBER 30, 2007

Established in 1947, the Profit Sharing / 401k Council of America (PSCA) is a national, non-profit association of 1,200 companies and their 6 million plan participants. PSCA represents its members' interests to federal policymakers and offers practical, cost-effective assistance with profit sharing and 401(k) plan design, administration, investment, compliance and communication. PSCA's services are tailored to meet the needs of both large and small companies. Members range in size from Fortune 100 firms to small, entrepreneurial businesses.

The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The vast majority of NAM members provide 401(k) plans for their employees and thus have a significant interest in this legislation.

The ERISA Industry Committee (ERIC) is a nonprofit association committed to the advancement of America's major employer's retirement, health, incentive, and compensation plans. ERIC's members' plans are the benchmarks against which industry, third-party providers, consultants, and policy makers measure the design and effectiveness of other plans. These plans affect millions of Americans and the American economy. ERIC has a strong interest in protecting its members' ability to provide the best employee benefit, incentive, and compensation plans in the most cost effective manor.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states, as well as 105 American Chambers of Commerce abroad. Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

We strongly support concise, effective, and efficient fee disclosure to participants. We also support increased fee transparency between service providers and plan sponsors. We commend Chairman Rangel for conducting this hearing to gain further insight into the employer-provided defined contribution retirement plan system and the critical role that plan fees play in retirement asset accumulation.

DEFINED CONTRIBUTION PLANS WORK FOR EMPLOYEES, EMPLOYERS, AND AMERICA

Employers offer either a defined benefit or defined contribution, and sometimes both types, of retirement plan to their workers, depending on their own business needs. According to the Investment Company Institute, Americans held $16.6 trillion in retirement assets as of March 30, 2007.[1] This is nearly 17% of the $97.9 trillion in

[1] *The U.S. Retirement Market, First Quarter 2007,* Investment Company Institute, , October 2007.

investible assets worldwide.[2] Government plans held $4.2 trillion. Private sector defined benefit plans held $2.3 trillion. Defined contribution plans held $4.2 trillion in employment based defined contribution plans and $4.4 trillion in IRAs. Employer-based savings are the source of half of IRA assets. Ninety-five percent of new IRA contributions are rollovers, overwhelmingly from employer plans.

There are questions about the ability of the defined contribution system to produce adequate savings as it becomes the dominant form of employer provided retirement plan. Some claim America is facing a retirement savings crisis. To answer this question, a baseline for comparison is required. The Congressional Research Service reports that in 2006, 23.6% of individuals age 65 and older received any income from a private sector retirement plan. The median annual income from this source was $7,200.[3] This income stream represents a lump-sum value of $90,000, assuming the purchase of a single-life annuity at an 8% discount rate. Individuals age 65-69 had higher median annual income from a private sector retirement plan, $9,600 ($120,000 lump sum value), but only 19.9% of those age 65 or older received any income from this source. Overall, however, the elderly are not impoverished. In 2006, 9.4% of Americans 65 and older had family incomes below the federal poverty rate, the lowest rate for any population group. How will the next generation of retirees fare compared to current retirees?

We hear about a negative savings rate in America, with some noting that Americans are saving less now than during the Great Depression. Intuitively, something must be wrong with this statistic as the total amount set aside for retirement has almost tripled in 12 years.[4] A 2005 analysis by the Center for Retirement Research sheds considerable light on the matter. They discovered that the NIPA (National Income and Products Account) personal savings rate for the working-age population was significantly higher than the overall rate, which was then 1.8%. Working-age Americans were saving 4.4% of income, consisting almost exclusively of savings in employment-based plans. This does not include business savings, which, of course, are owned by individuals. Those 65 and older were “dissaving” at negative 12% because they were spending their retirement assets, which are not considered income. The report accurately predicted that, as baby-boomers begin to retire, they will consume more than their income and the savings rate as currently defined would go even lower.[5]

The Congressional Research Service reports that married households in which the head or spouse was employed and the head was age 45-54 held median retirement account assets of $103,200 in 2004. Similar unmarried households held $32,000. An identical married

[2] *Tapping Human Assets to Sustain Growth: Global Wealth 2007*, Victor Aerni, Christian de Juniac, Bruce M. Holley, Tjun Tang, October 12, 2007.
[3] *Income and Poverty Among Older Americans in 2006,* Congressional Research Service, September 24, 2007.
[4] *The U.S. Retirement Market, First Quarter 2007*, Investment Company Institute, , October 2007.
[5] *How Much are Workers Saving?,* Alicia Munnell, Francesca Golub-Sass, and Andrew Varani, Center for Retirement Research at Boston College, October 2005.

household headed by an individual age 55 and older held median retirement account assets of $119,500 in 2004.[6]

While some workers have enjoyed a full working career under a defined contribution plan such a as profit sharing plan, 401(k)-type plans in which the employee decides how much to save have existed for only slightly over twenty years, and most participants have participated in them for a much shorter period of time. The typical participant in 2000 had only participated in the plan for a little over seven years.[7] Policymakers must be wary of statistics citing average 401(k) balances and balances of those approaching retirement because they have not saved over their full working career and some balances belong to brand new participants. For example, a recent Investment Company Institute report stated that at the end of 2006, the average 401(k) balance was $61,346 and the median balance was $18,986.[8] The median age of the participants in the study was 44 and the median tenure in their current 401(k) plan was eight years. But when the study looked at individuals who were active participants in a 401(k) plan from 1999 to 2006 (including one of the worst bear markets since the Depression) the average 401(k) balance at the end of 2006 was $121,202 and the median balance was $66,650. Long-tenured (30 years with the same employer) individuals in their sixties who participated in a 401(k) plan during the 1999-2006 period had an average account balance of $193,701 at the end of 2006. The study does not reflect that many individuals and households have multiple 401(k)-type accounts or assets rolled over into an IRA.

The lesson is clear – long term participation in a 401(k) plan will result in the accumulation of assets adequate to provide a secure retirement. The Congressional Research Service estimates that a married household that contributes ten percent of earnings to a retirement plan for 30 years will be able to replace fifty-three percent of pre-retirement income. If they save for forty years, they will replace ninety-two percent of income.[9] A ten percent savings rate is realistic given average contribution rates of seven percent and average employer contributions of three percent. These estimates do not consider Social Security payments

These statistics mean little if a worker is not saving for retirement. And one fact is abundantly clear – whether or not a worker saves for retirement is overwhelmingly determined by whether or not a worker is offered a retirement plan at work. In March of 2007, sixty-one percent of private sector workers had access to a retirement plan at work and fifty-one percent participated. Seventy percent of full-time workers had access and sixty percent participated. Seventy-eight percent of workers in establishments employing 100 or more workers had access and sixty-six percent participated. Only forty-five percent of workers in establishments of less than 100 workers had access to a plan and

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[6] *Retirement Savings: How Much Will Workers Have When They Retire*?, CRS Report For Congress, January 29, 2007.

[7] *Rise of 401(k) Plans, Lifetime Earnings and Wealth at Retirement*, James Poterba, Steven F. Venti, and David A. Wise, NBER Working Paper 13091, May 2007.

[8] *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, Investment Company Institute, August, 2007.

[9] *Retirement Savings: How Much Will Workers Have When They Retire*?, CRS Report For Congress, January 29, 2007.

thirty-seven percent participated. Three-quarters of workers earning at least fifteen dollars per hour had access and sixty-nine percent participated. Only forty-seven percent of workers making less than fifteen dollars per hour had access and only thirty-six percent participated. Seventy-seven percent of all workers chose to participate when offered a defined contribution plan at work, with seventy percent of those making less than fifteen dollars per hour opting to participate.[10] Policymakers should consider that these participation rates are at a single point in time. They are not indicative of whether or not a individual or household will choose to participate in a 401(k) plan for a substantial period of a working career.

Opportunities for improvement

What do all these data tell us? First, the employer provided defined contribution system has demonstrated that it can provide asset accumulation adequate for a secure retirement for workers at all income levels as long as individuals participate. The participation rate when offered a plan is encouraging, but can be improved. There are two areas in which to concentrate our efforts on improvement; lower-paid workers and small business plan coverage. We also need to increase participation by African-Americans and some ethnic groups, as revealed by some very recent studies. Small business owners need simplicity and meaningful benefits for themselves to compensate for the costs of providing a plan to their workers. Congress should keep this in mind as they examine plan fees.

We believe that making the 2001 EGTRRA pension provisions permanent in the Pension Protection Act of 2006 will help convince small business owners to offer a plan. Permanency removed a cloud of uncertainty that likely would have frozen small business plan growth in its tracks. We commend Congress for enacting this very important provision.

We also believe that the growth of automatic enrollment plans will substantially increase retirement plan participation by lower and middle income workers that are most likely to be induced to save by this type of plan design. Ninety percent of workers that are automatically enrolled chose not to opt out of the plan.[11] A 2005 ICI/EBRI study projects that that a lowest quartile worker reaching age 65 between 2030 and 2039 who participates in an automatic enrollment program with a 6% salary deferral (with no regard for an employer match) and investment in a life-cycle fund will have 401(k) assets adequate for 52% income replacement at retirement, not including social security that provides another 52% income replacement under today's structure.[12]

The important automatic enrollment provisions in the Pension Protection Act are already producing results. In the latest PSCA survey of 2006 plan year experience, 23.6% of plans have automatic enrollment, compared to 16.9% in 2005, 10.5% in 2004, and 8.4%

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[10] *National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2007* U.S. Department of Labor, August 2007.

[11] *Hewitt Study Reveals Impact of Automatic Enrollment on Employees' Retirement Savings Habits*, Hewitt Associates, October 25, 2006.

[12] *The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement*, EBRI Issue Brief no. 238, July 2005..

in 2003. 41% of plans with more 5,000 or more participants reported utilizing automatic enrollment in our survey. A recent Hewitt survey indicated that 36% of respondents offered automatic enrollment in 2007, up from 24% in 2006. 55% of the other respondents are "very likely or somewhat likely" to offer automatic enrollment in 2007.[13] Vanguard reports that 80% percent of plans that implemented automatic enrollment in 2007 elected a "full autopilot design" that includes automatic deferral increases, a marked departure from earlier automatic enrollment plans.[14]

DOL REGULATORY FEE AGENDA

Fee disclosure and transparency present complex issues. Amending ERISA through legislation to prescribe specific fee disclosure will lock in disclosure standards built around today's practices and could discourage product and service innovation. The DOL has announced a series of regulatory initiatives that will make significant improvements to fee disclosure and transparency**. We support the DOL's efforts and have been active participants in them. While legislative oversight of DOL's disclosure efforts is appropriate, we believe that this is the best approach to enhance fee transparency in a measured and balanced manner and we urge Congress to delay taking legislative action until the DOL has completed its work**.

We believe that the regulatory scheme of soliciting input and issuing proposed and final rules based on comments from all affected parties will result in carefully-structured rules that will avoid unintended consequences. Moreover, regulatory guidance is dynamic. It can be more readily clarified and amended to adapt to changing conditions. Legislation, on the other hand, is cast in stone until changed, and change can be very difficult to enact for reasons totally unrelated to core issues when pension issues are consolidated into larger bills.

Among DOL's fee disclosure efforts are revised annual reporting requirements for plan sponsors. We expect DOL to release finalized modifications to the Form 5500 and the accompanying Schedule C, on which sponsors report compensation paid to plan service providers, in the very near future. The modifications will significantly expand fee disclosure to plan sponsors, including all asset-based fees and service provider revenue-sharing. The final regulations implementing the new Form 5500 are expected to first be applicable to the 2009 plan year. The DOL will also require that the Form 5500 be filed electronically for plan years beginning in 2009. This change will make it possible for extensive "data-mining" of the expanded fee information in the revised Form in a short period of time. We expect that this new information will be very useful for fee benchmarking that it will help reduce some plan fees.

DOL also intends later this year to issue a revised regulation under ERISA Section 408(b)(2), which is a statutory rule dictating that a plan may pay no more than reasonable compensation to plan service providers. The expected proposal is designed to ensure that

[13] *Survey Findings: Hot Topics in Retirement 2007*, Hewitt Associates
[14] *How America Saves 2007*, Vanguard

plan fiduciaries have access to information about all forms and sources of compensation that service providers receive (including revenue-sharing). Both sponsors and providers will be subject to new legal requirements under these proposed rules, including an anticipated requirement that all third party compensation be disclosed in contracts or other service provider agreements with the plan sponsor.

The DOL's remaining initiative focuses on revamping participant-level disclosure of defined contribution plan fees. DOL issued a Request for Information ("RFI") in April 2007 seeking comment on the current state of fee disclosure, the existing legal requirements, and possible new disclosure rules. We filed individual comments and also all issued a joint response with seven other trade associations. The DOL has indicated that it intends to propose new participant disclosure rules early in 2008 that will likely apply to all participant-directed individual account retirement plans.

THE ERISA FRAMEWORK

Numerous aspects of ERISA already safeguard participants' interests and 401(k) assets. Plan assets must be held in a trust that is separate from the employer's assets. The fiduciary of the trust (normally the employer or committee within the employer) must operate the trust for the *exclusive* purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. In other words, the fiduciary has a duty under ERISA to ensure that any expenses of operating the plan, to the extent they are paid with plan assets, are reasonable.

To comply with ERISA, plan administrators must ensure that the aggregate price of services in a bundled arrangement is reasonable at the time the plan contracts for the services and that the aggregate price for those services continues to be reasonable over time. For example, asset-based fees should be monitored as plan assets grow to ensure that fee levels continue to be reasonable for services with relatively fixed costs such as plan administration and per-participant recordkeeping. The plan administrator should be fully informed of all the services included in a bundled arrangement to make this assessment.

Many plan administrators, however, may prefer reviewing costs in an aggregate manner and, as long as they are fully informed of the services being provided, they can compare and evaluate whether the overall fees are reasonable without being required to analyze each fee on an itemized basis**.** For example, if a person buys a car, they don't need to know the price of the engine if it were sold separately. They do need to know the horsepower and warranty. Small business in particular may prefer the simplicity of a bundled fee arrangement. Congress should consider the need to increase plan sponsorship by small business if it considers legislating changes to bundled fee disclosure arrangements.

It is important that as it considers new legislation, Congress fully understand the realities of fees in 401(k) plans. There are significant recordkeeping, administrative, and compliance costs related to an employer provided plan, which do not exist for individual retail investors. And net performance compared to an appropriate benchmark is more important than a fund's investment management fees. Nevertheless, the vast majority of participants in ERISA plans have access to capital markets at *lower cost* through their plans than the participants could obtain in the retail markets because of economies of scale and the fiduciary's role in selecting investments and monitoring fees.

The Investment Company Institute reports that the average overall investment fee for stock mutual funds is 1.5% and that 401(k) investors pay half that amount.[15] The level of fees paid among all ERISA plan participants will vary considerably, however, based on variables that include plan size (in dollars and/or number of participants), participant account balances, asset mix, and the types of investments and the level of services being provided. Larger, older plans typically experience the lowest cost. Congress should also realize that employer provided plans are often the only avenue of mutual fund investment available to lower-paid individuals who have great difficulty accumulating the minimum amounts necessary to begin investing in a mutual fund or to make subsequent investments. Finally, to the degree an employer provides a matching contribution, and most plans do, the plan participant is receiving an extraordinarily higher rate of return on their investment that a retail product cannot provide.

A study by CEM Benchmarking Inc. of 88 US defined contribution plans with total assets of $512 billion (ranging from $4 million to over $10 billion per plan) and 8.3 million participants (ranging from fewer than 1,000 to over 100,000 per plan) found that total costs ranged from 6 to 154 basis points (bps) or 0.06 to 1.54 percent of plan assets in 2005. Total costs varied with overall plan size. Plans with assets in excess of $10 billion averaged 28 bps while plans between $0.5 billion and $2.0 billion averaged 52 bps. In a separate analysis conducted for PSCA, CEM reported that, in 2005, its private sector corporate plans had total average costs of 33.4 bps and median costs of 29.8 bps.

Other surveys have found similar costs. HR Investment Consultants is a consulting firm providing a wide range of services to employers offering participant-directed retirement plans. It publishes the 401(k) Averages Book that contains plan fee benchmarking data. The 2007 edition of the book reveals that average total plan costs ranged from 159 bps for plans with 25 participants to 107 bps for plans with 5,000 participants. The Committee on the Investment of Employee Benefit Assets (CEIBA), whose more than 115 members manage $1.4 trillion in defined benefit and defined contribution plan assets on behalf of 16 million (defined benefit and defined contribution) plan participants and beneficiaries, found in a 2005 survey of members that plan costs paid by defined contribution plan participants averaged 22 bps.

It is important that before Congress considers any legislation to enhance disclosure of these fees, that they fully understand the lower-than-retail fees many employees are already enjoying in their 401(k) plans.

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[15] *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses*, 2006, Investment Company Institute, September 2007.

PRINCIPLES OF REFORM

As we stated earlier, we do not oppose effective and efficient disclosure efforts. We believe that the following principles should be embodied in any effort to enhance fee disclosure in employer-provided retirement plans.

- **Sponsors and Participants' Information Needs Are Markedly Different.** Any new disclosure regime must recognize that plan sponsors (employers) and plan participants (employees) have markedly different disclosure needs.

- **Overloading Participants with Unduly Detailed Information Can Be Counterproductive**. Overly detailed and voluminous information may impair rather than enhance a participant's decision-making.

- **New Disclosure Requirements Will Carry Costs for Participants and So Must Be Fully Justified.** Participants will likely bear the costs of any new disclosure requirements so such new requirements must be justified in terms of providing a material benefit to plan participants' participation and investment decisions.

- **New Disclosure Requirements Should Not Require the Disclosure of Component Costs That Are Costly to Determine, Largely Arbitrary, and Unnecessary to Determine Overall Fee Reasonableness.** We believe that the requirement to "unbundled" bundled services and provide individual costs in many detailed categories is not particularly helpful and would lead to information that is not meaningful. It also raises significant concerns as to how a service provider would disclose component costs for services that are not offered outside a bundled contract. Any such unbundling would be subject to a great deal of arbitrariness. These costs will ultimately be passed on to plan participants through higher administrative fees. The increased burden for small businesses could inhibit new plan growth.

- **Information About Fees Must Be Provided Along with Other Information Participants Need to Make Sound Investment Decisions.** Participants need to know about fees and other costs associated with investing in the plan, but not in isolation. Fee information should appear in context with other key facts that participants should consider in making sound investment decisions. These facts include each plan investment option's historical performance, relative risks, investment objectives, and the identity of its adviser or manager.

- **Disclosure Should Facilitate Comparison But Sponsors Need Flexibility Regarding Format**. Disclosure should facilitate comparison among investment options, although employers should retain flexibility as to the appropriate format for workers.

- **Participants Should Receive Information at Enrollment and Have Ongoing Access Annually.** Participants should receive fee and other key investment option information at enrollment and be notified annually where they can find or how they can request updated information.

We strongly urge that the requirements of any new 401(k) fee-related legislation be measured against these principles.

CONCLUSION

We support effective fee disclosure. However, we strongly believe that the additional flexibility inherent in the regulatory system make DOL a more appropriate place for new disclosure requirements. DOL already has numerous initiatives underway to enhance disclosure between plan sponsors and participants and between plan sponsors and service providers. Any new legislative requirements would likely only slow those efforts resulting in delayed reforms.

Plan sponsors and service providers alike are committed to creating new investment options and administrative techniques to improve retirement security. Automatic enrollment, automatic contribution step-ups, target-date and lifecycle funds, managed accounts are just some of the numerous innovations that have benefited 401(k) participants and enhanced their retirement security. Statutory requirements for fee disclosure would freeze disclosure in the present, making enhancements and innovations more difficult in the future.

We appreciate the opportunity to present our views on this very important matter.