TESTIMONY BEFORE THE ERISA ADVISORY COUNCIL WORKING GROUP ON FEES AND RELATED DISCLOSURES TO PARTICIPANTS

Edward Ferrigno
Vice President
Profit Sharing / 401k Council of America

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The Profit Sharing / 401k Council of America (PSCA) is a non-profit national association of employers who sponsor defined contribution retirement plans for their workers. For over fifty-five years, PSCA has identified and shared best practices with its members, represented their interests in Washington, and provided analysis and reportage on the latest regulatory changes. PSCA members range in size from very small independent businesses to firms with hundreds of thousands of employees. Our members believe that profit sharing, 401(k), and related savings and incentive programs strengthen the free-enterprise system, empower and motivate the workforce, improve domestic and international competitiveness, and provide a vital source of retirement income.

While participants in qualified employer sponsored defined contribution plans need to be cognizant of the fees associated with their plan investments, ERISA reduces the risk of improper fees being inflicted on plan participants by imposing a fiduciary requirement on plan sponsors to insure that any fees paid with plan assets are reasonable. This oversight requirement is in addition to the regulation of fees by other agencies, such as the Securities and Exchange Commission. As a result, employer plan participants have less need for detailed fee disclosure than other investors. PSCA believes that concentrating on improving the disclosure of fees to plan sponsors and assisting them in determining the reasonableness of those fees is the best way to insure that plan participants do not pay unreasonable fees. PSCA also notes that many plan sponsors voluntarily provide excellent fee disclosure to participants far in excess of any statutory requirement. We expect that market pressures will expand this practice.

ERISA mandates significant disclosure of fees to participants who direct their investments in an employer provided plan structured to meet the requirements of section 404(c). Participants must be informed of any commissions or sales charges that will affect their account balances as the result of their investment choice. For investments in mutual fund products, a prospectus or fund profile is provided immediately after the initial investment. The prospectus contains the fund's expense ratio, which includes the management fee of the fund's investment manager.

PSCA supports improving the information included in a mutual fund prospectus by mandating that additional expenses presently reported in the fund's Statement of Additional Information (SAI) be included in the prospectus. Today, brokerage fees incurred by mutual funds are normally not included in the expense ratio included in the prospectus - they are reported in the SAI, which is available upon request, but is not provided automatically. According to some experts, brokerage fees can be a major portion of overall fund fees. The recent SEC rule banning directed brokerages and the debate over soft dollar payments, which are included in brokerage fees, will help alleviate this problem, but the remaining brokerage fees should be included in the prospectus and fund profile.

PSCA recommends that the Department of Labor determine if the information provided in a mutual fund prospectus regarding investment management and other fees is provided to participants who select other types of investments in plans structured to meet the section 404(c) requirements. If not, the regulations should be changed to achieve this condition.

Section 404(c) requires that a description of the annual operating expenses of each designated investment be provided upon request. However, there is no requirement to affirmatively provide any information after the initial investment, even if the costs affiliated with an investment decision changes. PSCA recommends altering section 404(c) so that changes in investment costs are provided automatically on an annual basis.

Mandatory fee disclosure to plan participants can produce unintended consequences. Employer provided retirement plans have created tens of millions of unsophisticated savers who absolutely would not be saving if these plans were not offered to them. These participants are shielded from the many pitfalls that exist for unsophisticated investors by plan sponsor fiduciary requirements that insure plan investments are prudent and fees are reasonable. Unsophisticated investors can be improperly influenced by relative plan fees if they do not understand what drives fee levels. For example, lower fees for money market funds could improperly influence a decision to avoid equity funds that may be a more appropriate investment class. Of course, education could eliminate this problem; but that would result in additional costs for either the participant or the plan sponsor to address a problem that may not exist. This illustrates the cost-benefit issues that accompany a discussion of enhancing fee disclosure to participants.

The disclosure of plan fees not connected with an individual's investment decision is another issue that needs to be addressed. These fees are for recordkeeping, systems administration, trustee fees, etc. In theory, these fees, and others, are reported in the Summary Annual Report (SAR) and provided annually to all participants. In our testimony to another working group, we point out that the Form 5500, from which the SAR is derived, can be extremely ineffective in reporting plan fees because asset based fees are generally not reported. The result is that the SAR provides very little information to help participants understand fees. If the Form 5500 is improved as we suggest, the SAR will follow suit. But the SAR reports aggregate expenses for the plan and is not helpful in identifying an individual participant's costs. Another commenter is proposing that general fees unrelated to a specific investment decision be calculated in a cost effective manner at the account level and provided to participants annually. PSCA is intrigued by this suggestion and recommends that it be investigated further.