

TESTIMONY BEFORE THE ERISA ADVISORY COUNCIL WORKING
GROUP ON PLAN FEE REPORTING ON THE FORM 5500

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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.

Form 5500 reporting no longer explicitly lists all of the expenses paid from retirement plan assets. This is especially true for defined contribution plans. As a result, Form 5500 fee related information is not useful to government policymakers, plan sponsors, plan participants, and others with an interest in this information. For example, in an actual case a plan with \$23 million in assets reported fees on the Form 5500 totaling \$695. In fact, the expenses paid from plan assets were approximately \$250,000.

When ERISA was enacted, and its attendant regulatory structure was developed, fees, expenses, and commissions paid by the plan were explicit and easily identifiable. Further, under generally accepted accounting principles, these fees were reported in the expense section of a qualified retirement plan's Statement of Income and Expenses. In other words, the actual fees, expenses, and commissions paid by the plan equaled the fees, expenses, and commissions in the plan's audit report. They were also reported on the Form 5500, which was validated by the plan's audit report.

However, as the mutual fund industry began to manage defined contribution plan assets in the 1980's, the situation changed. Mutual fund fees, expenses, and in some cases, commissions are not explicitly stated. They are netted out of plan assets when the mutual fund net asset value (NAV) is determined on a daily basis. Further, under generally accepted accounting practices, the fees, expenses, and in some cases the commissions, paid for mutual fund services are combined with a

fund's gains and losses and reflected only, and indirectly, in the income section in a plan's Statement of Income and Expenses. The Department of Labor (DOL) expects that plan-paid fees, expenses, and commissions reported on the Form 5500 be the same as the expenses identified in the plan's audit accompanying the Form 5500. The end result is that these payments are not included in the Form 5500. This condition exists in nearly all defined contribution plans and some defined benefit plans and results in a substantial percentage of the fees, expenses, and commissions paid by qualified retirement plans not being reported on the Form 5500.

The fact that a substantial portion of the expenses paid from retirement plan assets are no longer explicitly reported on the Form 5500 makes fiduciary oversight of plans more difficult and has reduced the transparency critical to fiduciary decision making. Originally, fiduciaries were assisted in meeting their responsibility to monitor the expenses paid by the plan because the reporting process itself required an annual identification of what the plan was paying. Further, Form 5500 data was available to fiduciaries and their advisors as a source of fee-related comparative information. Additionally, the universality and discipline of the Form 5500 fee reporting process insured the transparency necessary to foster the trust upon which the defined contribution system is based.

The recent disturbing financial scandals have placed a renewed emphasis on the requirement that plan fiduciaries insure that any and all fees paid with plan assets must be reasonable. More importantly, the trustworthiness of plan related fiduciary decisions must be beyond reproach. If the Form 5500 was changed to again include all plan-paid fees, both those explicitly shown as expenses on the plans' statement of income and expenses and asset based fees netted out of plan returns, plan fiduciaries would be assisted in meeting their fiduciary responsibilities. The resulting transparency would reduce doubts about the credibility of defined contribution system.

PSCA recommends that the DOL level the playing field for all service providers by insuring that the most beneficial aspects of schedules A and C are applied to all providers. Additionally, the DOL should advocate extending the requirement to provide plan administrators with the information needed to file the Form 5500 in a timely manner, pursuant to ERISA section 103(a)(2), to other service providers.

While the Form 5500 may be the most readily available tool for modification to assist plan sponsors in their duty to review plan expenses, other alternatives also should be considered. The Department of Labor worked with several industry groups to develop a fee worksheet designed to assist plan sponsors in analyzing and comparing proposed plan fees during negotiations with service providers. PSCA also provides a fee worksheet on its web site. The Department of Labor

should consider convening a broad government-industry joint effort to revisit and update its fee worksheet and obtain a commitment from plan service providers to use the worksheet to present proposed fee arrangements when they are soliciting potential clients. In addition, the Department of Labor could encourage the use of the worksheet in its educational campaigns for plan sponsors and in future guidance regarding plan fees.

The shortcomings in the existing regulatory structure's ability to help plan sponsors understand fees are offset by practices occurring in the market place. Many service providers present extensive information during the procurement process and on a recurring basis. To paraphrase one provider, "When you have a good story to tell, you want to tell it." PSCA believes that market pressures for extensive fee disclosure will accelerate due to the renewed emphasis on fees. Nonetheless, regulatory changes are probably required to address providers that are not following these best practices.

The changes that have impacted Form 5500 fee filing have also raised questions about whether or not a fiduciary needs to understand the underlying components of fees to determine if a bundled wrap fee is reasonable. The Department of Labor should consider clarifying its position on this issue. If a plan sponsor has determined that a bundled wrap fee is reasonable considering the services included, for example by benchmarking other plans with similar characteristics and features, is there a requirement for the sponsor to make the same determination for each underlying service? If the Department decides that the individual components must be examined by the fiduciary, the Form 5500 Schedule H that is filed by small plans may have to be amended to identify specific expenses.

ERISA and its accompanying regulations intend a full reporting on the Form 5500 of all fees, expenses and commissions charged to a qualified retirement plan. The Summary Annual Report that is provided to plan participants is derived from fees reported on the Form 5500. Implementing changes in the Form 5500 fee reporting process will assist plan fiduciaries; but more importantly, it will insure the transparency necessary for the continued growth and success of the defined contribution system.