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WORKING FOR AMERICA'S RETIREMENT

Ashton Testifies Before ERISA Advisory Council

Testimony Before the ERISA Advisory Council on Behalf of the American Society of Pension Actuaries Working Group on Fee and Related Disclosures to Participants

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Good morning. My name is Bruce Ashton. I am a partner of Reish Luftman Reicher & Cohen, in Los Angeles, California. My firm specializes in employee benefits and tax matters.

I am here today to present the views of ASPPA, which I currently serve as President. ASPPA is a national organization of almost 5,500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants, and attorneys. ASPPA's membership is diverse, but united by a common dedication to the private retirement plan system.

ASPPA applauds the Council's leadership in exploring whether disclosures to participants regarding fees and expenses which affect their retirement savings is adequate. We support the principle of full, open and transparent disclosure to plan sponsors regarding the operation of a plan, and we urge that full and fair disclosure be provided to plan participants to enable them to make informed investment decisions and more effectively manage their retirement assets.

Background

Employer sponsorship of defined contribution plans, particularly participant-directed 401(k) plans, has grown steadily over the past 20 years. By year-end 2003, an estimated 42 million workers in the United States participated in 401(k) plans, holding assets of approximately $1.9 trillion.

Given the significant amount of money in defined contribution plans, the fees incurred by participants in 401(k) and other participant-directed plans in their individual accounts is a major factor in determining whether a participant will ever achieve retirement security. Every dollar that goes towards expenses and not into a plan's investment options potentially represents thousands of dollars in lost retirement benefits. For example, over a 25 year period, a participant account that bears expenses of 0.5% would accumulate 28% more in retirement income than a similar plan bearing 1.5%.

Fees and expenses are, of course, an inherent and necessary part of the administration and operation of defined contribution plans. Further, the per participant cost of operating a plan covering 100,000 participants is notably less than the per participant cost of operating a 20 life plan. And, what may be an unreasonable per participant cost for the 100,000 life plan may be inadequate for the smaller plan to obtain the services it requires. ASPPA believes, however, that while the disclosure of plan fees and expenses must be considered in the context of the services provided, full disclosure of all plan fees and expenses charged against a plan participant's individual account in a defined contribution plan should be provided to each participant.

Fee and Expense Disclosure to Plan Participants

As a practical matter, although current law requires some disclosures of fees and expenses to plan participants, participants generally remain uninformed about how much they are being charged. This is in part due to the fact that expenses can be charged to a participant's accounts in a variety of ways, depending on the

type of product (e.g., group annuity, contract or mutual fund), whether services are bundled or unbundled, and what services are being provided to participants (e.g., investment advice).

Many different types of fees can be charged to a participant's account, based on how the plan is invested and administered. Some fees are charged to the account to pay the third party administrator for the services it provides to the plan. Some plan expenses occur as a result of commissions paid to a broker-dealer for investments that are purchased. Still other expenses are charged internally by a mutual fund in which the participant invests some of his or her account.

Insurance providers generally package their 401(k) investments in the form of group annuities and charge a wrap fee, which is an all-inclusive annual fee imposed on the value of all the assets in the account. This fee is often partially or fully offset by reduced investment management fees charged on the underlying assets or 12b-1 fees received by the insurance company. In any case, wrap fees affect the investment return to the participant. Mutual funds impose asset-based administrative fees and expenses that will range widely depending on the type of fund and share class offered.

Plans may be charged a variety of other fees and expenses, which commonly are allocated to participants' accounts. There are ongoing administrative costs for a 401(k) plan, such as trustee services, recordkeeping, compliance, distribution of account proceeds to departing participants, loan processing and withdrawals. Other expenses charged to a plan can include set-up and conversion costs, communication expenses and investment advisory fees. These costs can be charged as a percentage of total plan assets or as a fixed amount per participant, or fees relating to a specific participant (such as those for a distribution or a loan) can be charged to the affected participant's account as they are incurred. Many plans use a combination of these fee structures.

There is also a wide variety of payment arrangements for fees in 401(k) and similar participant-directed plans. Some plan sponsors pay for all administrative costs, while others pay virtually none of the costs of the plan, with the result that nearly all fees are paid by the participants' individual accounts.

Current rules relating to the disclosure of plan related fees and expenses to plan participants, such as those required to be provided under ERISA Section 404(c), the summary annual report (SAR) and the summary plan description (SPD), only go so far in advising the plan participant of what he or she is really paying out his or her account. It is our view that this is vital information necessary to enable participants to understand their retirement plan accounts and manage their assets effectively by making fully informed investment decisions. Therefore, ASPPA believes that plan participants should receive full and complete disclosure of all fees and expenses paid out of plan assets that can be reasonably be identified, as well as 12b-1 and/or sub-TA fees and the basis for crediting those fees.

ASPPA acknowledges that in the defined contribution plan world, there are as many structures for the payment of fees and expenses from plan assets as there are creative minds, and we cannot possibly address them all in this testimony. We also recognize that service arrangements for a plan can sometimes be quite complicated and how each of the service professionals is paid out of aggregate fees need not necessarily be a disclosable item to plan participants. What ASPPA believes is critical, however, is that the fees a participant is paying directly out of his or her account be fully disclosed, on an individual basis where possible or on an aggregate basis where this is not reasonably practicable.

ASPPA's Recommendation

ASPPA recommends that to enable plan participants to make a fully informed investment decision, disclosure of those fees and expenses charged to their individual accounts should be provided in a meaningful and understandable format. Therefore, we propose that participants be provided each year with a list of any fees charged in relation to each of the investment alternatives available in the plan, to the extent that such fees can be reasonably identified on an aggregate basis. In addition, the participant statement should also disclose any other plan-related fees—such as wrap fees, underlying contractual fees, TPA fees, etc.—that are charged to participants' accounts and that can also be

reasonably identified on an individual basis where possible or an aggregate basis if not. For plans that invest participant accounts through a group annuity contract rather than directly in mutual funds or other securities, we would encourage rules promoting consistency in reporting the net performance of the separate accounts; in our experience, there is currently disparity in how investment returns within separate accounts are communicated to participants.

To minimize the plan sponsor's administrative burden, this disclosure could be distributed in conjunction with the plan participant's regular year-end account statement. The disclosure would be written in a simple and easy to understand format, reflecting the aggregate fees charged by the investment alternatives and the other plan-related expenses. The expenses may be communicated in percentage or dollar form, whichever is more administratively feasible for the service provider. Although specific disclosure of the amount actually charged to a participant's account may be preferable, the burden of providing this individualized information is significant. It is ASPPA's belief that providing such participant-specific information could ultimately have a chilling effect on the creation and maintenance of such plans, particularly by small businesses.

Some plans offer "open brokerage windows" to their participants. These are self-directed 401(k) plans which allow plan participants to invest in a vast, or virtually unlimited, number of non-designated securities or mutual funds. ASPPA believes that it would be unfeasible for a plan sponsor to disclose to the plan participant many of the costs sustained through open brokerage windows except possibly for identified transaction fees and plan-related fees that could be segregated and shown to be charged on a per participant basis. Disclosures of other types of expenses charged against the participant account may be available in brokerage statements, and we believe that these would, of course, be provided to the participants. In general, however, we suggest that the sponsor of such a plan would need to issue an affirmative statement to the plan participant advising that, if the participant selects the open brokerage window, the participant would be responsible for obtaining adequate fee and expense information for the investment selections on his or her own.

A plan sponsor may have several different service providers for its plans, which would entail assimilating the fee disclosure information from several sources. We believe in the majority of these cases, however, ASPPA's proposal should not cause undue hardship for the service provider or plan sponsor.

Clarification Sought Under ERISA Section 404(c)

The regulation under ERISA 404(c) contemplates that certain information be automatically provided to participants. This includes the delivery of a prospectus or summary prospectus for securities subject to the Securities Act of 1933. In addition, the plan must automatically provide a description of any transaction fees and expenses affecting designated investments and, upon request, a description of the annual operating expenses of each designated investment alternative which reduces the rate of return to the participants, as well as information relating to the value of units and the past and current investment performance of such alternative.

The information required in non-404(c) plan is, of course significantly less. ERISA only specifically requires that plan participants be provided a SAR that indicates how much money the plan paid in expenses for the plan year, both in administrative expenses and other expenses. This amount is not broken out on a participant-by-participant basis, but listed as a single sum. Our recommendation regarding fee and expense disclosure would, to some degree, reconcile this imbalance.

ASPPA believes that the Section 404(c) requirements with respect to fee disclosure to participants should remain with one exception, where we believe clarification is required. The 404(c) regulation currently requires that "In the case of an investment alternative which is subject to the Securities Act of 1933, and in which the participant or beneficiary has no assets invested, [the participant must be provided] immediately following the participant's or beneficiary's initial investment, [with] a copy of the most recent prospectus provided to the plan." [29 CFR § 2550.404c-1(b)(2)(i)(B)(1)(viii)]

For plans that invest in mutual funds, many providers satisfy the securities law requirement for delivery of prospectuses by distributing the prospectuses for all

the mutual funds offered by the plans at their enrollment meetings. Thereafter, however, plans are generally unaware that a participant has invested in a mutual fund in which he or she had no previous assets, since participants may change their investment directions using voice response units (VRU) and/or Web sites without any involvement by the plan. As a result, many plans are unable to comply with this element of 404(c). ASPPA requests guidance that this 404(c) requirement can be satisfied by providing participants with a prospectus or profile for all the plan's designated mutual funds when: (a) they enroll in the plan; (b) new funds are added; and (c) a conversion occurs. Additionally, participants could be notified by e-mail, a popup screen with a link to the prospectus, or other effective means, that they may obtain prospectuses or profiles upon request.

Closing Remarks

ASPPA believes our suggestions for new fee and expense disclosure to plan participants represents a strong step toward better transparency and a more secure retirement. ASPPA would be happy to work with DOL to develop a prototype format for this proposed disclosure statement. I would be pleased to answer any questions.

Biography of Bruce L. Ashton, Esq., APM

Bruce is a partner of the law firm of Reish Luftman Reicher & Cohen, specializing in employee benefits. His practice focuses on all aspects of employee benefits issues, including representing plans and their sponsors in controversies before the IRS and EBSA, negotiating the resolution of plan qualification issues under the Employee Plans Compliance Resolution System, advising and defending fiduciaries on their obligations and liabilities under ERISA, and structuring qualified plans and non-qualified deferred compensation arrangements. He currently serves as ASPPA's President and has served on ASPPA's Board of Directors and as Co-chair of ASPPA's Government Affairs Committee.