



CRS Report for Congress

H.R. 3185: The 401(k) Fair Disclosure for Retirement Security Act of 2007

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Summary

As households become more reliant on 401(k) plans for retirement income, policymakers have become more concerned that participants are unaware of the fees charged in their 401(k) plans. Small differences in fees charged can have large impacts on 401(k) account balances upon retirement. This report provides information on the kinds of fees that are charged in 401(k) plans and details the provisions of H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act as introduced on July 14, 2007. It was passed by the Committee on Education and Labor by a vote of 25-19 on April 16, 2008. It will be updated to reflect other 401(k) fee disclosure legislation.

Background on 401(k) Fees

The Structure of 401(k) Plans and the Importance of Fees

Many employers provide defined contribution retirement plans to their employees. In defined contribution plans, employees and/or employers contribute to an individual employee's account, which accrues investment returns. Upon retirement, employees use the accounts as a source of income. Defined contribution plans may be "qualified" if they meet certain Internal Revenue Service (IRS) guidelines with respect to pension plan contributions, benefits, and distributions. 401(k) plans are qualified plans that include a cash or deferred arrangement under which participants can choose to contribute part of their before-tax compensation to the plan rather than receive the compensation in cash. 29 U.S.C. § 402(g)(1) allows employees to contribute a pre-tax maximum of \$15,500 in 2008 to their individual 401(k) accounts.

Three groups are affected by fees associated with 401(k) plans: (1) plan participants, (2) plan sponsors, and (3) service providers. The plan participants are the employees of the company who have individual accounts to which the employees, the employer, or both contribute. The plan sponsors are the employers. They arrange for service providers to administer the plan. Service providers provide a number of services for plan sponsors and

participants including the day-to-day plan business such as recording transactions, arranging for loans, or cashing out retirees' accounts. Service providers may provide all of the services to a plan or may contract out some or all plan services. Prior to choosing a service provider, plan sponsors might ask several providers for details on the products they offer and the fees they charge.

Under the Employee Retirement Income Security Act (ERISA, P.L. 93-406), plan sponsors have a fiduciary responsibility; that is, they must carry out their responsibilities prudently and solely in the interest of the plan's participants.¹ Among other duties, fiduciaries have a responsibility to ensure that the services provided to their plan are necessary and that the cost of those services is reasonable.

There has been a growing interest in the fees that participants in 401(k) plans are charged. Small differences in fees will have large differences in account balances at retirement, especially in the case of yearly or recurring fees.² For example, **Table 1** shows the effect that a 0.5%, a 1.0%, and a 1.5% annual fee would have on an initial \$20,000 account balance that earns 7% yearly. After 20 years, the account would have about \$77,000 if no fee is charged, whereas the account would have about \$70,000 if a 0.5% fee is charged. The account would have 17% less (or a balance of about \$58,000) if a 1.5% fee is charged. The complexity of 401(k) plan arrangements may provide opportunities for fees to be higher than they otherwise might be, particularly if plan sponsors and participants are not fully informed of the fees they pay. Policies that increase the transparency of fee arrangements may result in participants paying lower fees.

**Table 1. Effect of Annual Fees on a \$20,000 Balance
(Assuming 7% Annual Return)**

	0.0% Annual Fee	0.5% Annual Fee	1.0% Annual Fee	1.5% Annual Fee
Account Balance After 20 years	77,394	70,473	64,143	58,355
Account Balance After 30 years	152,245	132,287	114,870	99,679

Source: CRS calculations.

Types of 401(k) Fees

The Employee Benefits Security Administration (EBSA) is an agency within the Department of Labor (DOL). It is charged with protecting the integrity of employee benefits, including retirement plans. An EBSA publication, *A Look At 401(k) Plan Fees*, describes three types of fees.³

¹ For more information see CRS Report RL34443, *Summary of the Employee Retirement Income Security Act (ERISA)*, by Patrick Purcell and Jennifer Staman.

² For a detailed analysis see CRS Report RL34213, *Retirement Savings Accounts: Fees, Expenses, and Account Balances*, by Patrick Purcell.

³ Available at [<http://www.dol.gov/ebsa/pdf/401kFeesEmployee.pdf>].

Plan Administration Fees. These are fees for the day-to-day operations of plans such as record keeping, accounting, legal, and trustee services. Additional services might also be provided, such as access to customer service representatives, educational seminars, or daily valuation. The amount charged for administrative fees can vary depending on the quantity and quality of the services offered. For example, service providers that offer website access with extensive online services might charge higher fees than service providers that provide only basic website services. Administrative fees may be charged either as a flat fee per participant or as a percentage of plan assets.

Investment Fees. According to the EBSA publication, *A Look At 401(k) Plan Fees*, investment-related fees are the largest component of 401(k) plan fees.⁴ These cover the costs of transactions within investment options, such as the trades a particular mutual fund makes. Some investment fees include the following:

- **Sales Charges:** These are also known as loads. A front-end load is charged upon investing in some mutual funds. Front-end loads reduce the amount of the initial investment. Back-end loads (also called deferred sales charges or redemption fees) are charged upon selling mutual funds.
- **Rule 12b-1 fees:** These are annual fees that may be charged by mutual funds from fund assets to pay for promotional costs and commissions to brokers and other salespeople. A point of contention is that service providers may receive 12b-1 fees for including particular mutual funds as investment options for participants in the plans they administer.
- **Soft dollar fees:** These payments are for brokerage firm services (such as research) other than commissions for trade execution.

Individual Service Fees. Individuals are charged fees that are associated with using optional features in a 401(k) plan, such as loan origination fees. Fee arrangements may also be “bundled” where some of the services provided or investment alternatives offered to a 401(k) plan may be offered for a single fee. From this single fee, the provider will then pay other providers who have been contracted to provide services to the plan.

Documents Required by Current Law

Current law requires some, but not all, 401(k) fees to be disclosed in three documents: Summary Plan Descriptions (SPDs), Account statements, and Summary Annual Reports.

Summary Plan Descriptions. SPDs describe how plans operate.⁵ Plan sponsors are required to automatically provide copies of these documents to plan participants upon enrollment and upon written request of plan participants. Among other items, SPDs contain information about eligibility and vesting requirements, plan benefits, and the source of contributions. Fees paid by third parties to service providers and relationships

⁴ Available at [<http://www.dol.gov/ebsa/pdf/401kFeesEmployee.pdf>].

⁵ See 29 CFR § 2920.103-2 and 29 CFR § 2920.103-3 for regulations concerning the style and contents of SPDs.

service providers have with third party providers of services are not required to be disclosed in the SPD.

Annual Report Form 5500. Form 5500 is required to be submitted annually by many ERISA-covered plans. It contains various schedules with information on the financial condition, the investments, and operations of the plans. On November 16, 2007, EBSA issued regulations to require disclosure of fee arrangements on form 5500. The regulation requires plan sponsors to disclose compensation that service providers receive from parties other than plan sponsors, for example, 12b-1 fees.⁶

Benefit Statements. Section 508 of the Pension Protection Act (P.L. 109-280) requires plan sponsors to provide participants in defined contribution plans with quarterly benefit statements if the investments are participant-directed and annual statements if the investments are not participant-directed. The quarterly benefit statement must include the value of each investment in the individual's account, an explanation of any limitations or restrictions on any right of the participant or beneficiary under the plan to direct an investment, and an explanation of the importance of a well-balanced and diversified investment portfolio for long-term retirement security.

H.R. 3185: The 401(k) Fair Disclosure for Retirement Security Act of 2007

Representative George Miller introduced H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007 on July 14, 2007. As introduced, this bill would require: (1) service providers to disclose more information on the fees associated with a particular 401(k) plan to plan sponsors and any relationships that service providers have with entities providing services to a 401(k) plan; (2) plan sponsors to inform 401(k) participants about their investment options and the kinds and amounts of fees associated with the investment options; (3) plan sponsors to provide each participant in a 401(k) plan with a detailed breakdown of the fees a participant paid in the previous year; (4) each 401(k) plan to include at least one investment option which is a nationally recognized market-based index fund; and (5) DOL to establish an Advisory Council on Improving Employer-Employee Retirement Practices.

Disclosures from Service Providers to Plan Sponsors

The following provisions in H.R. 3185, as introduced, would require service providers to provide fee information to plan sponsors of 401(k) plans for any contract greater than \$1,000.

- H.R. 3185 would require that plan sponsors receive a Service Disclosure Statement from 401(k) plan service providers. The statement would identify who would be performing services under the contract and the costs of such services. In cases where services are bundled or the costs

⁶ See Department of Labor, "Annual Reporting and Disclosure," *72 Federal Register* 221, November 16, 2007, pp. 64710-64730.

are unknown, H.R. 3185 would require service providers to reasonably allocate costs among the bundled services.

- At a minimum, the expected cost of the following services would be identified in the Service Disclosure Statement: commissions for making sales; start-up fees; investment management expenses; estimated trading expenses; administration and record keeping expenses; legal fees; trustee fees; termination charges; total asset based fees; 12b-1 fees; soft dollar commissions; and other costs as specified by the Secretary of Labor.
- H.R. 3185 would require disclosure of any conflicts of interest that a service provider has with the plan sponsor or any third party providing services to the plan for which the service provider receives a payment
- H.R. 3185 would require disclosure of the existence of different share classes within the mutual fund investments offered. For example, mutual funds may offer a number of share classes that offer differing services (with differing fees) or offer share classes that are available only to institutional investors.

Disclosures from Plan Sponsors to Plan Participants

The following are provisions in H.R. 3185 that would require plan sponsors to provide fee information to all plan participants where the participant exercises control over the assets in the account.

- H.R. 3185 would require plan administrators to provide an “Advance Notice of Available Investment Options” to all plan participants on an annual basis. The following information would be required for each investment option: the name of the option; the investment objective; the risk level; whether the option by itself achieves long-term financial security; the historical return; the percentage fee; an explanation of any asset-based fees and/or annual fees; and a comparison to a nationally recognized index or benchmark.
- H.R. 3185 would require a fee menu that would detail the potential service fees that could be assessed against the account in the plan year. The fee menu would have to provide information in relation to the following three categories of fees: (1) fees that vary depending on the investment option selected (e.g., expense ratios or asset-based fees); (2) fees that are assessed as a percentage of total assets in an account; and (3) administration fees that are either automatically deducted each year or that are transaction-based (such as loan origination fees).
- The fee menu would have to describe the purpose of each fee and disclose the extent to which conflicts of interest may exist with respect to service providers or other parties receiving fees.

Annual Benefit Statement to Plan Participants

The following are provisions in H.R. 3185 that would require plan sponsors to provide information to each plan participant regarding the fees paid in his/her account.

- H.R. 3185 would require plan sponsors to provide each plan participant with an annual statement that discloses the following information: the starting and ending balances of the participant's account; the vesting status (e.g. whether the employee is eligible to keep the employer's contributions to the account); the percentage net return for the year; fees assessed for the year; the participant's asset allocation categorized by investment option, including the change in each asset's value during the year and the net return of each asset expressed as both a dollar amount and a percentage; and the service fees charged for each asset investment option, including the underlying investment fees and expense ratios, load fees, asset-based fees, mortality and expense charges, guaranteed investment contract fees, employer stock fees, brokerage charges, plan administration fees, total fees, and total fees as a percentage of current assets. Plan sponsors may provide reasonable estimates of fees in any case where the actual fee is not known.

Minimum Investment Option Requirement

H.R. 3185 would require 401(k) plans to include at least one investment option that is a nationally recognized market-based index fund. The bill does not specify a particular fund, but examples might include mutual funds that replicate the movements of the Dow Jones Industrial Average or Standard & Poor's (S&P) 500 index.

Advisory Council on Improving Employer-Employee Retirement Practices

H.R. 3185 would establish an Advisory Council on Improving Employer-Employee Retirement Practices in DOL. The duties of the Council would include the following:

- The Council would hold hearings, issue advisories on pension plan best practices, present academic and peer-reviewed research regarding pension plan best practices, and maintain a presence on the DOL website.
- The Council would issue an annual report on the state of retirement income security in the United States that includes data on operation of employer-sponsored pensions and recommendations for reform.