

# PENSION RIGHTS CENTER

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September 8, 2008

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Attn: Participant Fee Disclosure Project, Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210

Re: Comments on Proposed Regulations on Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans

We are submitting comments on the Department of Labor's proposed regulations for fiduciary requirements for disclosure in Participant-Directed Individual Account Plans. The Pension Rights Center is a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families.

As the Department of Labor noted in its preamble to the proposed regulations, and as the Department of Labor's Advisory Council on Employee Welfare and Employee Retirement Plans noted in a 1998 report on fees in defined contribution plans, high fees can have a substantial negative effect on an employee's retirement savings in a defined contribution plan. And the evidence is strong that in many defined contribution plans, particularly 401(k) plans sponsored by small and medium sized firms, fees exceed reasonable levels.

The proposed regulations create a new regulatory regime for disclosing fees and investment performance information to participants. While we think that the proposal springs from good intentions and incorporates some sound ideas, it is, in many respects, problematic. The regulations will not ensure that adequate information is provided to participants to help them make intelligent decisions on how to invest plan assets, or, indeed, whether to participate in the plan at all. Moreover, the regulations provide some information that may mislead the typical investor, resulting in some investors making poorer, rather than wiser, decisions. In addition, the regulations fall short on providing participants with sufficient information to evaluate the performance of the fiduciaries responsible for selecting investment alternatives and negotiating fees with third parties.

Our specific concerns include the following:

1. *The regulations should require that fees be unbundled.* The regulations' most significant short-coming is that they do not require that fees for broad categories of services be separately stated, but rather allow fees to be bundled.<sup>1</sup>

Particularized information about the nature and size of fees is critical to responsible investing. When fees are bundled, however, participants are denied this information. Fee unbundling is critical to providing participants with the information they need to choose among investment alternatives (and decide whether to participate in the plan). Moreover, with bundled fees, a plan record keeper may be able to overburden non-proprietary funds with excess fees, making its proprietary funds more attractive. Bundled fees may thus result in participants who invest in certain investment alternatives subsidizing the recordkeeping and other fees of participants who invest in other alternatives.<sup>2</sup>

Bundled fees also mask the cost of particular services, some of which might not be used by most participants. If the costs of such services were more transparent, participants might ask the plan sponsor to drop the services or charge the costs of the services directly to the participants who use them. Finally, when administrative services are bundled with investment fees, it becomes more likely that vendors of investment vehicles will reap windfalls when asset growth exceeds the incremental additional costs of providing administrative services.

We are aware that to provide this information it will be necessary for investment vendors who currently bundle fees (or who receive revenue sharing or similar payments from other parties) to modify their current business practices. But such transitional costs for vendors do not seem too large a price for the vendors' ability to participate in one of the largest investment markets in the world, and it is reasonable to require that market participants play by rules that maximize transparency. We also know that there are technical issues involved in requiring that fees be separately stated, but we believe that the Department of Labor should be able to draw on the considerable investment expertise of other federal agencies and the private markets to create a workable regulatory regime in which fees for broad categories of services are separately stated.

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<sup>1</sup> 401(k) plan fees and expenses generally fall into three categories: plan administration fees, individual service fees, and investment fees. Some employers may provide for or negotiate these services separately and the expenses charged by each provider (record keeper, investment manager, etc.) are charged separately. This is referred to as an "unbundled" arrangement. In the case of unbundled arrangements, the proposed regulations require that the dollar amount of plan administration fees be disclosed to participants in quarterly benefit statements. Other plans may have some or all of the services offered by one provider for a single fee and that provider will then pay out of its fee any other service providers it may have contracted with to provide services. This is a "bundled" arrangement. The proposed regulations do not require disclosure of plan administration fees in bundled arrangements.

<sup>2</sup> It should also be noted that unbundled fees would permit fee disclosures to include benchmarks for different types of fees.

It is also worth observing that some observers have suggested that the proposed regulations, by requiring greater transparency when fees are not bundled, will result in more plans contracting with vendors who bundle fees. This would further undercut efforts to improve transparency.

*2. Plans in Which Participants Do Not Have Investment Choice.* The proposed regulations require disclosure to participants in plans where employees allocate their accounts among several investment alternatives, but do not apply to plans where the investments are professionally managed for the participants as a unitary group. But participants in the latter plans also have a need to know the investment and administrative fees for which they are paying, to assist them in their planning for retirement and to evaluate fiduciary performance. The regulations should extend fee disclosures to participants in such plans.

*3. Description of Investment Information.* The proposed regulation requires the provision of summary investment performance information. This requirement is undoubtedly in response to the concern expressed by many observers that the provision of fee information only might lead some unsophisticated participants to opt for the lowest fee funds without regard to performance. Unfortunately, the summary performance information could result in another problem with this group of participants: they may opt for the highest performing funds without regard to risk. We submit that this is a far greater danger and if it cannot be averted, the fee information should stand alone. In fact, the required disclosure fails to provide even summary descriptions of each alternative or notation of the level of risk associated with each investment.

While we agree that furnishing participants with excessive information can be counterproductive, this does not mean that the optimal level of disclosure is the least disclosure. We do not see how participants who are unwilling or technologically ill-equipped to search web sites for information on each of their investment alternatives are served with the scant summary information required by the regulations. Indeed, the regulations, seem to adopt a name, rank, serial number approach to disclosure: they require written disclosure for each investment alternative of only the following: (1) category of investment, (2) form of management (passive or active); and (3) historical performance data (with a market benchmark). This is insufficient and may result in some investors selecting the investment with the highest historical return—without regard to risk or the value of portfolio diversification—since this is what the disclosure statement appears to isolate as the key determinant of the value of an investment. We note that the Federal Thrift Savings Plan provides understandable summary paragraphs for each investment alternative and might be a starting model for better disclosure than the proposed regulations would require.

We also recommend that if performance data is included in the final regulations, the regulations specify that investment return be reported net of fees.<sup>3</sup> In addition, there

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<sup>3</sup> The definition of “average annual total return” refers to Securities and Exchange Commission Form N-1A, which requires that investment performance be disclosed net of fees, but since some plan fiduciaries

should be a requirement that key terms such as expense ratio, basis points, large-cap fund, operating expenses, active management and passive management, etc., be clearly defined.

4. *The Regulations Should Not Reduce Investment Disclosure.* The regulations currently in effect under ERISA §404(c) require that a prospectus be provided to participants for each investment alternative offered by the plan. The proposed regulations, which would replace these rules, do not require provision of prospectuses. Instead, they merely require plans to provide information on how to access prospectuses on the Internet. Many participants are more likely to read a prospectus if they are provided with a hard copy than if they must access the Internet. We urge that the new regulations focus on improving disclosure rather than weakening it.

5. *Expenses Charged to Individuals.* The regulations require that expenses charged directly to individual participants be disclosed. We think it probable that some participants will not understand the significance of some of these charges. We thus believe the regulations should provide information to help individuals understand the nature of the charges and the impact they can have on return. As an example, we note in the sample disclosure chart in the regulations, that one investment imposes a \$20 annual service fee on accounts with less than \$10,000. The average return for this fund over the previous 5-year period was .22% and 8.9% for the previous year. If a participant had invested \$1,000 in this account and the fund returned on average 2% annually over the next five years, the account balance would not have grown at all during this period. And if the returns during this period were initially lower than 2%, the return would have been negative over those five years, notwithstanding the 2% average rate of return. We do not think this will be apparent to many participants. In addition, we are skeptical that all participants are aware of how, for example, a “4.25% deferred sales charge against amounts invested or redeemed,” might affect their investments.

6. *Correlation of fee disclosure and investment disclosure.* The typical participant reading the Model Comparative Chart would not know whether the “average annual total return” for a fund on Part I reflected the fees separately stated on Part II (both annual operating fees and shareholder and shareholder-type fees).

7. *Timing and Method of Disclosure.* The proposed regulations permit general fee and investment disclosure to be made in a plan’s summary plan description and require that modifications to the general disclosures be made by the 30<sup>th</sup> day following the adoption of a material change. While providing information in the summary plan description is useful, we believe that providing a stand-alone disclosure to participants when they first commence plan participation, and annually thereafter, would better serve participants and put only a mild additional burden on plan sponsors. We also believe that material changes in fee and investment information should be reported to participants before, rather than after, they are adopted.

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may not be familiar with the SEC requirements, the fact that investment return must be shown net of fees should be made explicit in the final regulations.

Finally, we want to note that promulgation of a regulation on fee disclosure requires two conceptually distinct inquiries: first, what information does a participant require about fees to make informed investment decisions; and second, how the information can be made intelligible to participants. The latter inquiry can be most effectively answered through testing various alternatives with actual participants. We urge the Department to undertake such a study.

Respectfully submitted,



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