From: Wagner, Eric [mailto:Eric.Wagner@unco.edu]
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To: EBSA, E-ORI - EBSA
Subject: 401(k) fee disclosures

Thank you for soliciting comments on the issue of fee disclosure surrounding 401(k) plans. I am the primary author of **Revenue Sharing in the 401(k) Marketplace – Whose Money is it?** (found at http://www.plantools.com/pdfs/RevenueSharingReport_9_01.pdf), published by McHenry Consulting in September of 2001. Now working in higher education, I continue to practice as an expert witness in significant cases related to this topic.

After 20 years working in the retirement field, I believe there the issues condense to three conceptual issues the DoL can and should address:

Economic models used by 401(k) service providers are fundamentally flawed.

All finance institutions try to match assets and liabilities (fee-based income to cover fee-based expenses, asset-based income to cover asset-based expenses, short-term liabilities/short term assets, long term liabilities/long term assets). The 401(k) business does not even attempt this. Taken as a whole, the business models of the 401(k) sevice providers are an arbitrary “underground 401(k) economy” diverting cash flow generated by Plan assets (employee money) to pay plan expenses and generate reasonable profit. The question is: “Do the Plan Sponsors have access to the information required for them to meet the reasonableness test for fees?”

The marketing of 401(k) services is driven entirely by Employer out-of-pocket costs.

Making the cost of their 401(k) invisible to employees is the service provider marketing mantra. This is done by “netting” Plan expenses against revenue generated by Plan assets. If all expenses are covered by this covert accounting, no overt bill is generated. If there is a balance due & billed, it is the only disclosed expense. Employers and employees have no idea what their true costs are. Most call it “revenue sharing”, but Fidelity has started insisting that their clients call it “Gain Sharing”. A rose by any other name...

401(k) service providers violate the Exclusive Use rules by diverting revenue generated by their profitable Plan clients to subsidize their unprofitable Plans.

The basic test of a given Plan’s profitability is how much income exceeds expenses. Since most Plan revenue is generated by asset-based investment management and shareholder servicing fees, the higher the average participant balance the greater the profit potential. Average balances of $20,000 per participant are the typical benchmark for minimum assets required for a Plan to be profitable. In cases where the average balance is too low to subsidize a smaller Plan’s expenses, the provider uses “excess” cash flow from profitable Plans to prop them up, creating “on average” a viable business model. Where the true Plan earnings disclosed to each plan before “excess” cash flow was diverted, this model would not survive because it would be obvious that it violated the law.

CAVEAT: Dallas Salisbury of EBRI discussed this with me, and he believes that this model is a social safety net. Equivalent to the “Haves” subsidizing the “Have Nots”, it is similar to the social security financing model. He believes that 401(k) would not survive in the small Plan market should this diversion of earnings between plans not be permitted. I agree. But it is still the law. Full disclosure would require a new pricing model.

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