AARP

TESTIMONY BEFORE THE

HOUSE COMMITTEE ON EDUCATION AND LABOR

ON

H.R. 3185, THE 401(k) FAIR DISCLOSURE FOR RETIREMENT SECURITY ACT OF 2007

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Mr. Chairman and members of the Committee, I am David Certner, Legislative Counsel and Legislative Policy Director at AARP. Thank you for convening this hearing on comprehensive, informative and timely disclosure of 401(k) plan investments and fees. AARP appreciates the opportunity to discuss this important issue, as well as H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007.

With more than 39 million members, AARP is the largest organization representing the interests of Americans age 50 and older and their families. About half of AARP members are working either full-time or part-time. All workers need access to a retirement plan that supplements Social Security's solid foundation. For those who participate in a defined contribution plan, such as a 401(k), better and easy to understand information is essential to help them make sound plan decisions. This is especially true for plans in which the participants have investment choices to make. Informed decision-making is key to future retirement income security.

There were approximately 50 million active participants in 401(k) plans in 2006, and overall, 401(k) plans held more than $2.7 trillion dollars in assets.[1] These plans have become the dominant employer-based pension vehicle. We all have a stake in ensuring that participants receive timely, accurate, and informative disclosures from their 401(k) plans – the better the understanding of how the plan operates, the better participants will be able to prepare for retirement. Today, it is clear that better disclosure of fee information is needed. The fee information participants currently receive about their plan is often scattered among several sources, difficult to access, or nonexistent. Even if it is accessible, plan investment and fee information is not always presented in a way that is meaningful to participants.

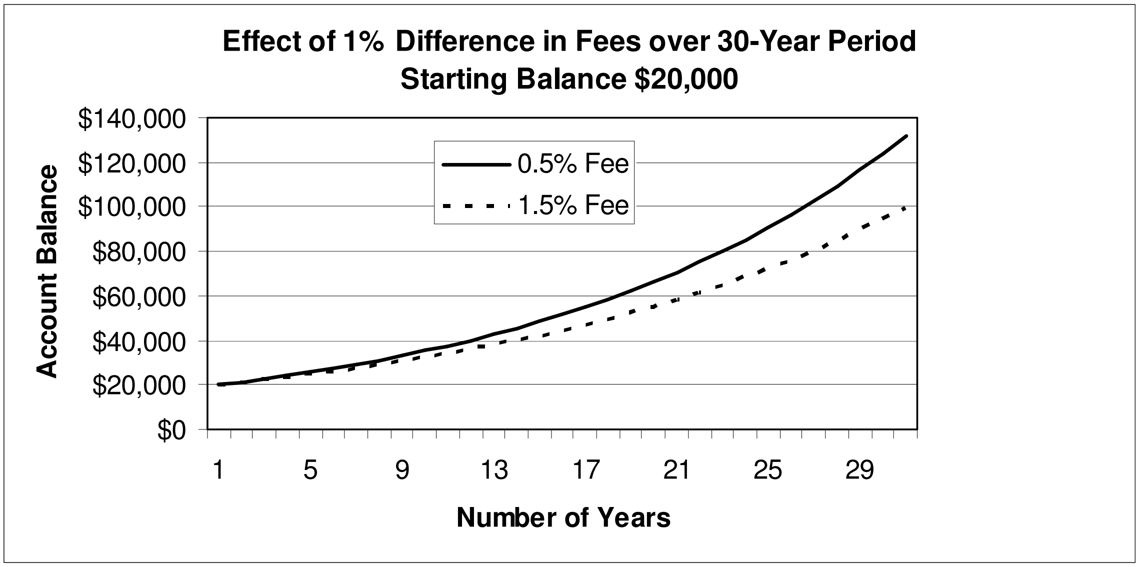
[1] EBRI *Issue Brief No. 308, August 2007*

Meaningful and easy to understand information is vital because the fees and expenses charged to participants significantly reduce the amount of assets available for retirement. Plan fees compound over time and the larger the fee, the bigger the bite that is ultimately taken out of the participant's retirement nest egg. Both plan sponsors and participants need to have the right information in order to make decisions that safeguard the plan's retirement income returns and enhance workers' retirement savings.

Some have suggested that added focus on fees and expenses is not important, that such costs do not add up to a significant impact. After all, even an additional 1% in fees – 100 basis points – is only $1.00 out of every hundred dollars. But this argument understates the impact that fees and expenses have on total return, especially compounded over long periods of time.

The U.S. Government Accountability Office (GAO) recently estimated that $20,000 left in a 401(k) account for 20 years could grow to $70,555 at 7% interest return minus a 0.5 percent charge for fees (6.5% net return). The same $20,000 would grow to only about $58,400 if the annual fees are 1.5% (5.5% net return). [2] The one percent fee differential has a dramatic impact – resulting in an over 17 percent reduction in the account balance over the 20-year period. Using GAO assumptions, AARP has estimated that over a longer 30-year period, the same $20,000 with a 0.5 percent charge would grow to $132,287, while a charge of 1.5 percent would reduce that growth to $99, 679 – about a 25 percent reduction in the account balance. Even a difference of only 50 basis points, from 0.5 percent to 1.0 percent, would reduce the value of the account by $17,417, or a little over 13 percent over the 30-year period.

[2] *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information,* GAO-07-21 (November 2006).



The chart assumes a 7 percent rate of return before fees are assessed.

Clear, usable information about plan investments and fees will help plan sponsors fulfill their fiduciary responsibility and avoid potential fiduciary concerns. It is important that there be greater transparency of fees and other expense information in order for plan sponsors to make prudent choices. Employers are obligated to ensure that fees paid to service providers and other plan expenses are reasonable, and they are required to monitor these expenses over time. Employers doing due diligence need to have access to costs associated with various components, not just total costs. This responsibility is of great importance for participants, since costs are often passed directly on to them.

In order to better manage their own accounts, individuals also need greater disclosure to better understand the numerous fees and expenses in the plan. Participants face a range of potential fees, including plan administration fees, investment fees and fees for individual plan services. Within these categories are a range of potential fees. For example, plan investment choices may include sales charges and investment advisory fees. The level of these fees can vary greatly depending on plan size and service provided. But these fees all have one thing in common – they will reduce the level of assets available for retirement.

Sound information can also provide participants with better tools to enforce their rights under the plan, including recovering lost benefits as a result of a breach of fiduciary duty. At least a dozen cases involving 401(k) fees have been filed in federal district courts, claiming fiduciary violations with respect to plan administration. The complaints center on allegations that 401(k) plans incurred unreasonable and excessive fees that were not adequately disclosed to participants.

Given the importance of fee information to both plan sponsors and plan participants, we applaud introduction of the 401(k) Fair Disclosure for Retirement Security Act of 2007 (H.R. 3185) by Chairman Miller. The legislation would require greater transparency of fee and expense information for both plan sponsors and plan participants. The greater disclosure required under this legislation will help drive down fees in the marketplace, will enable plan sponsors and plan participants to be better consumers, and will ultimately lead to greater retirement income security.

AARP's Survey Results: Participants' Understanding of Fees

While plan participants have been asked to take on more risk and responsibility for their 401(k) plan, they often find the plan investment choices, as well as their associated fees and expenses, a mystery. AARP recently surveyed 1,584 401(k) participants to gauge their understanding of the fees they pay and the factors they consider in selecting the investments offered by their plans. "401(k) Participants' Awareness and Understanding of Fees, July 2007" indicates that participants do not always have a clear grasp of the investment options offered by their plans or what they are invested in. When asked if they know the names of all the funds in which they have money invested through the 401(k) plan, almost 65% of survey respondents said no. And, when types of investments were described, survey respondents did not always know whether they had money in that investment. For example, 27% did not know whether their plan offered a stock fund and about as many, 29%, did not know whether their plan had a bond fund. 401(k) participants would benefit from additional information about the investment options in the plan.

When asked about the sources of information used to make investment decisions, 57% of respondents who make investment decisions for their 401(k) plan indicate they refer to a summary of the plan's investment choices. Other sources include prospectuses (34%), research analysts' recommendations (22%), financial articles (17%), and televised financial broadcasts (14%). The fact that more than half of the respondents consulted the plan's summary of investment materials helps emphasize the importance of plan-provided summary information.

In addition, many 401(k) participants lack basic knowledge of the fees associated with their plan. When asked whether they pay any fees for their 401(k) plan, less than one-fifth (17%) said they do pay fees. Almost two-thirds responded that they do not pay fees (65%) and 18% stated that they do not know.

When told that 401(k) providers often charge fees for administering the plans and that the fees may be paid by the employer as a sponsor or by the participants in the plan, 83% of those surveyed acknowledged that they do not know how much they pay in fees, while 17% said they did.

Respondents were questioned in some detail about the kinds of fees that may be charged for mutual funds and other types of investments. The answers indicate that 401(k) participants do not necessarily understand what types of fees their plans are charging. For example, when asked whether their 401(k) plan charged an administrative fee, 24% said yes, 21% said no, and 55% replied that they did not know. A similar question was posed about redemption fees. Seven percent of the survey respondents said they were charged a redemption fee, but 27% replied that they were not and 65% did not know.

When participants were provided possible definitions of an administrative and a redemption fee, 51% of the respondents correctly identified the administrative fee and 38% correctly identified the redemption fee. Approximately one third (37%) stated they did not know which statement correctly identified an administrative fee and more than half (55%) said they did not know which statement correctly identified a redemption fee.

The 401(k) Fair Disclosure for Retirement Security Act of 2007

The 401(k) Fair Disclosure for Retirement Security Act of 2007 (H.R. 3185) would ensure that 401(k) service providers provide plan sponsors with comprehensive information on service fee and expense information. The bill would also require notice to participants of investment option information, including risk and fees to the participant. It would create a new annual benefit statement and require that at least one plan investment option be a nationally recognized market-based index fund.

H.R. 3185 would establish a solid framework for providing comprehensive information to plan sponsors that could then be synthesized and given to participants along with required investment option information. In establishing itemization of different categories of fees, bundled service arrangements would essentially have to be un-bundled for clearer presentation of the costs. Requiring that plan service providers give comprehensive information to plan sponsors will provide the plan sponsors with the resources they need to fulfill their fiduciary duties.

H.R. 3185 would not extend disclosure requirements to all individual account plans, just 401(k) plans. Participants in other individual account plans, such as

ERISA-covered 403(b) plans, are also subject to investment costs or administrative fees, and those participants have a right to know what is being charged to their accounts. AARP urges that all individual account plan participants have access to investment and fee information.

The provision establishing a new annual benefit statement would provide a comprehensive picture of a participant's status in the 401(k) plan. This provision will need to be coordinated with the new Pension Protection Act requirements for a quarterly benefit statement in order to enhance consistency and effectiveness of the information.

AARP supports the bill's requirement that the plan investment options include a nationally recognized market-based index fund. This option would ensure that all plans provide participants with access to the market at the generally lower expense levels associated with index funds.

AARP recommends that information on an investment's fees demonstrate how they will affect the participant's account balance over time. Participants need to know how fees and expenses of an investment compare with others offered by the plan as well as similar investments in the market. GAO recently suggested that participants be provided the expense ratio for each investment as an effective way to compare fees, especially within the context of the investment's risk and historical performance.[3]

AARP also recommends including in the information furnished to participants whether employer stock is an investment option because the plan terms so provide. Too many employees continue to hold excessively large amounts of employer stock in their 401(k) plans. Clarifying why employer stock is among the available choices may help participants choose investments that reflect their

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[3] *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information,* GAO-07-21 (November 2006).

personal goals, rather than reflect a value judgment about the return or risk associated with the employer stock. H.R. 3185 already includes a provision requiring that employer stock fees be included in the disclosure to participants. This information, which would complement the Pension Protection Act's provisions on disclosure and diversification, would add additional context to the information about employer stock that would help participants make a more informed decision.

Conclusion

AARP commends Congressman Miller for introducing H.R. 3185 to strengthen investment and fee disclosures to 401(k) sponsors and participants. The legislation represents an important step to require necessary information and ensure that it is effectively communicated. The significant impact of fees on retirement security, as well as the results of AARP's survey of 401(k) participants, highlights the need for clear investment and fee information. We look forward to working with this Committee to ensure that both employers and participants have the information they need to best ensure an adequate retirement income level.

Thank you for the opportunity to testify today.