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Office of Regulations and Interpretations  
Employee Benefits Security Administration, Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue, N.W.  
Washington, DC 20210

Attn: Participant Fee Disclosure Project

Ladies and Gentlemen:

The Investment Company Institute, the national association of U.S. investment companies,<sup>1</sup> strongly supports the Department of Labor's participant fee disclosure proposal, which will require that participants and beneficiaries in all self-directed defined contribution plans receive basic and comparable information on all the investment options available to them, regardless of type.

Under the proposal, participants would receive, at enrollment and annually thereafter, basic information about the plan, including plan-level fees. They would receive a chart containing information about each investment option designated by the plan fiduciaries, including the type of investment, whether it is active or passive, the investment's 1-, 5-, and 10-year return (compared against a benchmark), and the fees associated with the investment alternative, with annual expenses expressed as a total expense ratio. Participants would be referred to a website for more information on each investment, including the investment strategies and risks, the identity of the investment issuer or provider, portfolio turnover, and the assets held in the portfolio. More detailed information, like a copy of a prospectus or similar document, would be available to participants upon request.

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<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.14 trillion and serve almost 90 million shareholders.

We applaud the Department for seeking input prior to issuing this proposal through its Request for Information. This process showed dividends. The proposal focuses on the key information of use to participants and provides for comparability and clarity. It provides key information on fees, balanced with layered web-based disclosure on other key information. Many features of the proposal help ensure that the disclosure is useful to participants, the requirements are clear to plan fiduciaries, who have the obligation to provide the disclosure, and that the disclosure regime is cost-effective for plans and service providers. We urge the Department to retain these features:

- ***Avoiding a focus solely on fees.*** The fees associated with a plan's investment options are an important factor participants should consider in making investment decisions, but no participant should decide whether to contribute to the plan or allocate his or her account based solely on fees. The Department should retain the balance struck in the proposal so that participants do not receive disclosure that places undue emphasis on fees.
- ***Disclosing investment expenses in a straightforward format through the expense ratio.*** The expense ratio is a simple and widely understood way to disclose annual operating costs of an investment fund that can be applied to a variety of pooled products. It has been time-tested in SEC rules for disclosing mutual fund operating costs. Use of the total expense ratio also ensures comparability across investment products.<sup>2</sup>
- ***Ensuring participants understand the costs for buying and selling the plan's designated investments prior to making a decision.*** The proposal contains a requirement to disclose shareholder-type fees, which should include fees imposed at the time of purchase (brokerage or insurance commissions, sales charges or front-end loads) or at the time of sale or redemption (redemption fees, deferred sales loads, surrender fees, market value adjustment charges). It is particularly important that participants, before making an investment decision, understand any fees for exiting the investment within a certain period of time.

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<sup>2</sup> We agree that fixed return products do not charge expenses in the same way that pooled products do. While an expense ratio may not be appropriate for GICs, certificates of deposit, and similar products (although it is for pooled funds of bonds or GICs), we recommend that the chart include a disclosure alerting participants that the cost of the fixed return product is built into the stated rate of return because the insurance company or bank covers its expenses and profit margin by any returns it generates on the participant's investment in excess of the stated rate of return.

- ***Applying disclosure across all products.*** This proposal would establish baseline disclosure of key information for all products, regardless of type. This would fill a gap in the current 404(c) regulation which requires that participants receive a prospectus for mutual funds and other products subject to the Securities Act of 1933, but does not require delivery of key information like annual operating expenses and historical return information for other investment products. Closing this gap is important as investment funds that are not subject to the 1933 Act are increasingly being marketed to plans and participants.<sup>3</sup> We recognize that current disclosure systems do not always require that this information be developed and made available to participants and that plans, recordkeepers, and product providers will need to develop processes to do so. But that is exactly the point of this proposal and why adoption is so necessary. We strongly urge the Department to retain this feature of the proposal.
- ***Allowing fees to be disclosed in the manner in which they are charged.*** The proposal allows fees to be disclosed in the manner in which they are charged, recognizing that different types of fees are charged differently. While operating expenses of pooled funds in the plan's menu are charged in basis points (percentage of assets), plan level fees typically involve per capita or per transaction costs.
- ***Coordinating participant disclosures with securities law disclosures.*** Throughout the proposal the Department coordinated the proposed requirements with similar disclosures registered investment companies provide investors. This has the benefit of using time-tested disclosure methodologies and avoids requiring mutual funds to recompute information or produce entirely new calculations beyond those currently required by the SEC. For example, the methodology for computing mutual fund expense ratios, performance data, and benchmark information will satisfy the rule.
- ***Harnessing the power of web-based disclosure.*** The Internet is a particularly effective and efficient means to deliver disclosure, because of its ability to offer layers of information. The proposal makes an important step in this direction by allowing use of a website to provide layered disclosure. Below we offer recommendations on how the Department should update its electronic disclosure rules for this proposal.

These principles enjoy broad support, as evidenced by the letter in response to the Department's RFI signed by 12 groups representing both employer sponsors of defined

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<sup>3</sup> See "Collective Funds Gain Traction in 401(k)s", *Wall Street Journal*, July 24, 2008, page D1.

contribution retirement plans and the financial institutions that provide services or investments to plans.<sup>4</sup>

Our comments on specific elements of the proposal are set forth below.

**A. The Department should enhance the ability of plans to use electronic delivery and web-based disclosure.**

Although the proposal contemplates the use of a website for layered disclosure, it otherwise simply incorporates the Department's current electronic disclosure rules. Benefits of the layered approach to disclosure in the proposal can best be realized if the Department updates its electronic disclosure rules.

Use of the Internet is now virtually universal among a significant majority of 401(k) participants. Participants under age 60 constituted 91 percent of active 401(k) participants at the end of 2006,<sup>5</sup> and in this age group, access to an Internet-enabled PC at home is generally above 80 percent, based on Nielsen ratings (as of May 2008).<sup>6</sup> The Institute's data on mutual fund shareholders, including those who own funds through employer plans, show broad Internet usage across all groups. For example, 75 percent of mutual-fund owning U.S. households with a high school education or less report having Internet access in 2006.<sup>7</sup> This number is even higher – 85 percent – for those with a high school education or less who own mutual funds through a 401(k).<sup>8</sup>

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<sup>4</sup> See Joint Letter of the Investment Company Institute, American Benefits Council, American Council of Life Insurers, Committee on Investment of Employee Benefit Assets, The ERISA Industry Committee, American Bankers Association, Profit Sharing / 401k Council of America, Securities Industry and Financial Markets Association, National Association of Manufacturers, U.S. Chamber of Commerce, The Financial Services Roundtable, and Society for Human Resource Management (July 24, 2007), available at [http://www.ici.org/statements/cmltr/2007/07\\_dol\\_401k\\_joint\\_com.html](http://www.ici.org/statements/cmltr/2007/07_dol_401k_joint_com.html).

<sup>5</sup> See S. Holden, J. VanDerhei, L. Alonso, and C. Copeland, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, ICI Perspective, vol. 13, no. 1, fig. 4, and EBRI Issue Brief, no. 308, Investment Company Institute and Employee Benefit Research Institute, August 2007, available at <http://www.ici.org/pdf/per13-01.pdf>.

<sup>6</sup> See Nielsen On-Line, *Industry Vertical News on Internet Penetration* (May 2008), available at [http://www.nielsen-netratings.com/resources.jsp?section=btn\\_filter&nav=5](http://www.nielsen-netratings.com/resources.jsp?section=btn_filter&nav=5).

<sup>7</sup> See 2008 Investment Company Institute Fact Book, 48th ed., figure 6.12, available at <http://www.icifactbook.org>. Educational attainment reported is for the sole or co-decisionmaker for savings and investing decisions.

<sup>8</sup> Data tabulated from ICI's 2006 Annual Mutual Fund Shareholder Tracking Survey.

The Internet is widely used for financial transactions. One Institute member with a large recordkeeping business reported to us that in 2007, about 75 percent of investment changes by participants were made on-line via the plan participant website, compared with about 25 percent of changes made over the phone.<sup>9</sup> A 2006 Institute study of Americans who own mutual funds (whether through employer plans or through the retail market) found that nearly three-quarters of shareholders who go online use the Internet to access their bank or investment accounts, and 55 percent use the Internet to obtain investment information.<sup>10</sup>

In a joint letter, the Institute and the American Benefits Council recently recommended that the Department consider alternatives to the affirmative consent requirement in the Department's current electronic disclosure regulation (29 C.F.R. § 2520.104b-1(c)). We understand that the issue of electronic delivery of information and documents required by ERISA is the subject of a separate regulatory project. We see no reason, however, why the Department could not include in these final regulations rules that facilitate electronic delivery of information required by these regulations. The Department has done so on an interim basis for e-delivery of participant benefit statements in Field Assistance Bulletin 2006-03 and for qualified default investment alternatives (QDIAs). The Department should adopt a similar user-friendly approach for this regulation.

For example, many plans enroll participants via a secure website. Participants designate a contribution percentage, enter enrollment information, and select investments at the same time. Information on investment options is presented at the time the participant selects investments, and the participant typically has the option to print any of this information. It is clear that any participant who enrolls via this process has access to the Internet *because the participant is online to enroll*. The Department's rules should allow the plan to furnish this participant with the required disclosures online.

The Department's final regulations for QDIAs allow plans to satisfy their notice requirements using either the Department of Labor's electronic disclosure rules or the guidance issued by the Department of Treasury and Internal Revenue Service (26 C.F.R. § 1.401(a)-21) relating to use of electronic media.<sup>11</sup> The process of notifying participants about a plan's QDIA

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<sup>9</sup> In fact, in 2007, 84 percent of all participant contacts with the recordkeeper were made via the participant website.

<sup>10</sup> See 2008 Investment Company Institute Fact Book, 48th ed., figure 6.13, available at <http://www.icifactbook.org>.

<sup>11</sup> See Preamble to Final QDIA rule, 72 Fed. Reg. 60452, 60458 (October 24, 2007). See also Field Assistance Bulletin 2008-3, Q&A-7.

typically will be intertwined with disclosure under this new rule. The Department needs to harmonize these rules with the QDIA electronic disclosure requirements.

Finally, as a technical matter, the Department should clarify that the use of a website to provide the additional investment disclosure described in paragraph (d)(1)(i)(B) of the proposal will not violate the Department's general electronic disclosure rules, so long as a participant can request and receive in paper the required information that is on the website.<sup>12</sup>

**B. Comments on the presentation and content of required information.**

**1. *The Department should clarify that the website information includes a description of the type of assets in the portfolio, not a list of securities in the portfolio.***

Under the proposal, participants must have access to a website address that provides supplemental information on each designated investment alternative, including “the assets comprising the investment’s portfolio.” We assume that the Department intended to require information about the *type* of assets in the portfolio, and not a list of every security held in the portfolio. The current 404(c) requirement is that participants receive “information relating to the type and diversification of assets comprising the investment’s portfolio.”<sup>13</sup> Requiring web-based continuous disclosure of portfolio holdings would be unnecessary and unwise.

Mutual funds are required to disclose their portfolio holdings on a quarterly basis under SEC rules. Funds provide this information as part of their required reports provided to shareholders twice a year,<sup>14</sup> and then during the two “off” quarters on Form N-Q, which is filed with SEC. The Department’s proposal would of course allow participants to obtain shareholder reports on request (see paragraph (d)(4)(ii)).

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<sup>12</sup> The Department should not require that all the information on the website, which may include information beyond that required by the rule, be available in paper at no charge. A requirement on the plan to provide a paper copy should be restricted to the information required by the regulation.

<sup>13</sup> See 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)(ii). In addition, one of the items that must be available upon request under the proposal is a list of assets comprising the portfolio that constitute plan assets and the value of each such asset; this requirement is redundant if the proposal is read to require that information be continuously available on a website.

<sup>14</sup> See SEC Form N-1A, Item 22(b)(1); Rule 30e-1 under the Investment Company Act of 1940. Many funds voluntarily disclose this information on their websites on a more frequent (*e.g.*, monthly) basis, with a lag time designed to avoid subjecting the fund to predatory trading practices.

There are good reasons why the SEC does not require mutual funds to disclose portfolio holdings continuously and contemporaneously. Besides the administrative burden and expense of doing so, this could have an adverse impact on funds and their shareholders, because it could subject funds to predatory trading practices like front-running and free riding.<sup>15</sup>

**2. *The Department should clarify that plans may provide additional benchmark comparisons.***

The proposal would require that participants receive, for each investment other than fixed return products, the name and 1-, 5-, and 10-year returns of an appropriate broad-based securities market index, for comparison purposes. The description of the required benchmark parallels what mutual funds provide pursuant to SEC Form N-1A.

Form N-1A recognizes that a broad-based securities index may not always provide the best comparison to a particular fund. The instructions to Form N-1A allow mutual funds to compare their performance not only to the required broad-based securities index, but also to other, more narrowly based indices that reflect the market sectors in which the fund invests or to use an additional broad-based index or non-securities index (*e.g.*, the Consumer Price Index), so long as the comparison is not misleading.<sup>16</sup> The Department should clarify that these additional comparisons are allowed.

**3. *The Department should clarify that investments with less than the full period of performance should disclose performance from inception date.***

The Department's proposal is modeled on SEC Form N-1A, which requires disclosure of performance over a 1-, 5-, and 10-year period, but the Department's proposal does not address explicitly how funds with less than a full period of performance should present their performance. SEC rules require that funds that have been in existence for less than a full period disclose performance for the life of the fund. For example, a fund that has been in existence for 9 years would disclose its 1- and 5-year performance and the performance over the 9 years since inception of the fund.

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<sup>15</sup> If the Department intends to require disclosure of actual portfolio holdings on the website, it should provide that mutual funds should provide this information with the frequency, currentness, and detail required by SEC rules.

<sup>16</sup> See SEC Form N-1A, Item 2(c)(2)(iii), Instruction 2(b); Item 22(b)(7), Instruction 6.

The model disclosure chart lists one of the funds (the “B Fund”) as “NA” for the 10-year performance figure, suggesting that “NA” should be used if the fund has been in existence for less than 10 years. We recommend that the Department clarify that plans should disclose the performance for the life of the investment if that is less than 1, 5, or 10 years, as applicable. This could be done by placing the performance over the life of the fund in the column for the next highest period, and including either an explanatory parenthetical or a footnote.

***4. If the Department retains the requirement to disclose portfolio turnover, it should clarify that funds should calculate portfolio turnover in accordance with Item 8 of Form N-1A.***

Website information for each designated investment alternative under the proposal includes the portfolio turnover rate. While we would not put fund portfolio turnover on a list of the most important pieces of information that all investors should review,<sup>17</sup> we understand that the Department may be concerned that participants have information about the trading costs of a fund. In that context the portfolio turnover rate can be an indicative measure, particularly for equity funds.

The SEC has determined that the fund’s turnover rate is the most reasonable proxy for the trading costs of a mutual fund. While it is not a perfect measure of trading costs,<sup>18</sup> it is a widely-used proxy for transaction costs, and it has the advantage of comparability. It can be easily calculated by funds and is more easily understood by investors than other measures.

If the Department decides to retain the requirement in the final rule, it should apply to all investment funds – mutual funds, collective trusts, separately managed accounts, and insurance company separate accounts.

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<sup>17</sup> In a survey of just over 500 households conducted in March 2008, ICI found that only 38 percent thought the section on portfolio turnover in the proposed Summary Prospectus was “very important, need to keep.” Indeed, the portfolio turnover section was ranked second from the bottom in the list of thirteen sections that respondents were asked to prioritize, and only the name of the portfolio manager received a lower percentage saying the information is “very important.” See Investment Company Institute, *Investor Views on the U.S. Securities and Exchange Commission’s Proposed Summary Prospectus* (March 14, 2008), available at [http://www.ici.org/pdf/ppr\\_08\\_summary\\_prospectus.pdf](http://www.ici.org/pdf/ppr_08_summary_prospectus.pdf). This finding confirmed earlier ICI research on investor preferences about portfolio turnover information. See Investment Company Institute, *Understanding Investor Preferences for Mutual Fund Information* (2006), available at [http://www.ici.org/pdf/rpt\\_06\\_inv\\_prefs\\_full.pdf](http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf).

<sup>18</sup> For example, a fund that frequently trades securities on a low cost-per-trade basis may incur lower overall transaction costs than a fund that trades infrequently but on a high cost-per-trade basis.



The Department should clarify that funds should calculate and disclose portfolio turnover in accordance with Item 8 of Form N-1A. This will assure comparability of disclosure across products. For example, Form N-1A instructs mutual funds, in calculating portfolio turnover, to exclude amounts relating to securities whose maturities or expiration dates at the time of acquisition were one year or less.<sup>19</sup> This is appropriate because the portfolio turnover rate is a measure of the relationship between the adviser's investment strategies and how frequently the portfolio turns over within a year.

Similarly, Item 8 of Form N-1A exempts money market mutual funds from the requirement to calculate and provide portfolio turnover.<sup>20</sup> Since money market funds almost exclusively hold very short-term interest-bearing securities (*e.g.*, 60 days), and hold them to maturity, most of the securities money market funds hold are exempt from the calculation because they have maturities of less than one year. However, because of a 1991 modification to the rules for money market funds, these funds can now purchase a security with a remaining maturity of up to thirteen months. To avoid requiring money market funds to calculate portfolio turnover on a small slice of their portfolios, the SEC simply exempted all money market funds from the requirement to calculate and provide their portfolio turnover rate.<sup>21</sup> Disclosing money market fund portfolio turnover rate could be misleading and would not provide a comparison against the other investment options in the plan. For example, a fund that maintains an average maturity of 60 days<sup>22</sup> would have a turnover rate of about 600%.

***5. The Department should clarify that shareholder-type fees that are waived for 401(k) investors should not be disclosed.***

The proposal would require disclosure of “shareholder-type” fees like front-end loads and redemption fees. It is very common for mutual funds, or share classes of funds, that impose a front-end sales load or account charges to waive the load or account fee for 401(k) and other

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<sup>19</sup> See Form N-1A, Item 8(a), Instruction 4(d)(ii).

<sup>20</sup> See Form N-1A, Item 8(a), Instruction 4(c).

<sup>21</sup> See SEC No-Action Letter to Investment Company Institute (pub. avail. Aug. 6, 1991). The SEC amended Form N-1A to reflect this interpretative position two years later. See Securities and Exchange Commission, Disclosure of Mutual Fund Performance and Portfolio Managers, Final Rule, 58 Fed. Reg. 19050, 19051 n.3 (April 6, 1993).

<sup>22</sup> The average maturity of taxable money market mutual funds has been lower than 60 days in every year since 1984. See 2008 Investment Company Fact Book, 48th ed., table 38, available at <http://www.icifactbook.org>.

defined contribution investors.<sup>23</sup> This would typically apply to all participants in a plan. We read the Department's proposal to provide that shareholder-type fees should be disclosed only if they apply to participants, but the Department should clarify this point. The example in the model comparative chart references a \$20 annual service fee that "[m]ay be waived in certain circumstances." The Department should clarify that if a fund does not impose the fee on that plan's participants, the waived fee should not be included.

In addition, the Department's proposal would require that the 1-, 5-, and 10-year performance be calculated and disclosed in the same manner as average annual total return is calculated under Item 21 of SEC Form N-1A. That instruction requires mutual funds to assume that the shareholder paid the maximum sales load. The Department should clarify that, if a fund does not impose a sales load on the plan or its participants, the chart could omit the performance numbers that would be required in the fund's prospectus and instead display the average annual total return without including the sales load (assuming the presentation is not inaccurate or misleading).

Finally, the Department should clarify that round trip or purchase block restrictions, which do not impose a fee for exiting an investment, but merely prohibit reinvestment in the same fund for short period of time to prevent market timing, are not considered "shareholder-type fees."<sup>24</sup>

**6. *The Department should retain the requirement to disclose quarterly only plan-level administrative fees in dollar amounts and not impose dollar-based disclosure for investment-level fees.***

Under the proposal, participants would be provided quarterly the amount actually charged to their account for plan administrative expenses and any fees charged for use of individual plan services (*e.g.*, loans). These administrative expenses exclude amounts otherwise included in investment-related expenses (which are disclosed to participants at enrollment and annually thereafter). The Department should retain this feature of the proposal.

The Department should not require that plans create individualized dollar-based disclosures for fees that are included in investment-related expenses. This would require

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<sup>23</sup> See B. Reid and J. Rea, *Mutual Fund Distribution Channels and Distribution Costs*, ICI Perspective, vol. 9, no. 3 (July 2003), available at <http://www.ici.org/pdf/per09-03.pdf>.

<sup>24</sup> The Department came to a similar conclusion with respect to QDIAs.

systems that are expensive to design and implement and which would produce rough estimates at best.

The SEC looked at this issue in the context of disclosure of mutual fund fees. A June 2000 General Accounting Office (now Government Accountability Office) report on mutual fund fees suggested various approaches to improving fee disclosure, one of which was to require that funds calculate and disclose to each fund investor the actual dollar amount of fund operating expenses attributable to that investor.<sup>25</sup> The SEC examined the GAO's report and concluded that the best way to improve shareholder understanding was to require a fee example in shareholder reports showing the expenses paid on each \$1,000 invested, based both on the fund's actual operating expenses and actual return for the period and, to allow comparisons among funds, based on an assumed return of 5 percent per year.<sup>26</sup>

In its adopting release, the SEC cited Institute research concluding that the aggregate costs to responding firms associated with calculating and disclosing individualized fund expenses on quarterly statements would be \$200.4 million in initial implementation and \$65 million in annual, ongoing costs.<sup>27</sup> This estimate covered only the costs for calculation and disclosure to retail investors. Providing this type of disclosure in 401(k) plans would be even more costly because a plan sponsor or recordkeeper must consolidate fee and account information with respect to each investment in a participant's account, information that derives from different sources. Current recordkeeping systems are not designed to receive the needed information from mutual fund companies and other financial product providers on a daily basis.

If the Department decides to modify the proposal to require that plans reduce asset-based investment charges into estimated dollar amounts, the Department should follow the illustrative example that accompanies the fee table in a mutual fund prospectus or the example in a fund's shareholder report.<sup>28</sup>

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<sup>25</sup> See General Accounting Office, "Mutual Fund Fees: Additional Disclosures Could Encourage Price Competition" (June 2000), available at <http://www.gao.gov/new.items/gg00126.pdf>.

<sup>26</sup> See Securities and Exchange Commission, Final Rule, Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, 69 Fed. Reg. 11244 (March 9, 2004).

<sup>27</sup> The Institute survey was conducted in 2000, and included responses from 39 mutual fund complexes with total net assets of \$4.8 trillion (approximately 77 percent of total industry net assets as of June 2000).

<sup>28</sup> A mutual fund's prospectus provides a quantitative example showing the dollar amount of expenses an investor would pay on a hypothetical \$10,000 investment that earns 5 percent annually over 1-, 3-, 5- and 10-year periods. This calculation number takes into account any sales charges imposed by the fund. The fund's semi-annual and annual reports include a table showing the expenses paid on each \$1,000 invested, based both on the fund's actual

**7. *The Department should retain flexibility of format for the information on the website.***

The proposal does not specify the format of the website information, and we agree plans should have flexibility in how to present this information. For example, many retirement services providers now use fund “fact sheets” or post web-based versions of fund fact sheets. These helpful tools, which are typically limited to one or two pages, provide basic information about a plan investment’s investment objectives, risk, historical performance, and fees, in a format that investors find useful. Innovative formats like these should be encouraged.

In some cases it may be cost effective for plans to provide at the designated website a copy of a mutual fund’s most recent prospectus, or a short-form or summary prospectus. In addition, particularly if a mutual fund’s public website will be used to disclose the information, the fund will need to ensure that information is presented in a way that complies with all securities laws.<sup>29</sup> Providing plans, service providers, and investment providers flexibility to use fact sheets, prospectuses or short-form or summary prospectuses (so long as the document includes the required information<sup>30</sup>) will allow plans to provide disclosure that works best for participants.

Although the Department should provide flexibility as to format, we urge the Department to provide guidance as to how the requirements apply to products other than mutual funds (which already provide the required website information). For example, we agree that participants should understand the risks of investing in a fixed return product. We recommend that the Department state that in describing the principal risks of these products, the plan should explain, at a minimum, that the risks associated with the fixed rate of return include the risks of interest rate changes, the long-term risk of inflation, and the risks associated with the product provider’s insolvency.

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operating expenses and actual return for the most recent six-month period and, to allow comparisons among funds, based on an assumed return of 5 percent per year.

<sup>29</sup> Along with the requirements of Form N-1A, other rules require that information about a fund be presented in a particular way. *See, e.g.*, Rule 482 under the Securities Act of 1933 (17 C.F.R. § 230.482).

<sup>30</sup> We believe a prospectus would include all of the information described in paragraph (d)(i)(B). As proposed, a summary prospectus would also include all of this information. *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, 72 Fed. Reg. 67790 (Nov. 30, 2007).

**8. *The Department should address changes in the cross-references to Form N-1A.***

The proposed regulations include references, by number, to items and instructions in the SEC's Form N-1A. The Department should clarify that these also refer to successor items and instructions. The items and instructions in Form N-1A are renumbered from time to time, and in fact the SEC's current proposed changes to Form N-1A would renumber some of them.

**C. *The Department should revise the timing requirements to accommodate plans with immediate eligibility.***

The Department's proposal would require that a host of plan and investment information be provided on or before eligibility. A failure to do so, under the Department's proposal, would be a breach of fiduciary duty. The point of the requirement to disclose the required information upon eligibility is to ensure participants have sufficient information to make the decision whether or not to enroll in the plan and how to allocate their contributions<sup>31</sup> among the options that plan fiduciaries have designated be available in the plan.

Many participant-directed defined contribution plans provide for immediate eligibility. For these plans, the Department's rule will require, essentially, that the disclosure be made on the first day of work. Many employers do not provide information on benefits on the first day of work, in part to avoid information overload with all the other information new employees must absorb. Plans with immediate eligibility could be vulnerable to violating the timing requirements, if even by a few days.

Plans with immediate eligibility typically have a lag time between the date a participant is eligible and the date of first investment, because the first paycheck (with the first plan contribution deducted) often does not occur on the first day of employment. We recommend that the Department amend the requirements so that fiduciaries will be deemed to have provided timely disclosure if it is provided on or within a reasonable period after the date the employee becomes eligible for the plan, but in any event on or before the date the employee makes his or her first election to contribute to the plan or first election to allocate his or her account to a designated investment alternative.

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<sup>31</sup> Under the proposal, the initial and annual plan-level information must identify "any designated investment managers," but does not define the term "designated investment manager." The preamble explains that this means "any designated investment managers to whom participants and beneficiaries may give investment directions." The Department should clarify that this plan-level disclosure needs to identify any person designated to receive and implement investment instructions from participants and beneficiaries (whether or not this person is an investment manager within the meaning of ERISA § 3(38)).

**D. The Department should extend the compliance date.**

While we believe participants are by and large already receiving the information required by the proposal, at least with respect to mutual funds, it may not be in the chart format, or at the times, required by proposal. There is programming that will be required, and coordination between plans, recordkeepers, and investment providers, which our members inform us would be impossible to complete by January 1, 2009. If the Department is able to finalize and publish the rule by the end of 2008, plans likely will be able to comply within a year, provided the Department does not substantially increase the burdens and disclosures of the proposal.

It is unclear whether the Department expects plans to provide the enrollment disclosure to all existing participants on the rule's effective date. This would be very difficult, since it would require that the industry create disclosures that would go out to millions of plan participants simultaneously. The Department should clarify that plans can provide to existing participants the annual disclosure within one year of the regulation's effective date. Moreover, to avoid piece meal compliance, the Department should require that plans come into compliance for new participants, and for quarterly statements, no later than when the plan provides its first annual update for the first plan year beginning on or after January 1, 2009.

**E. While we agree that the proposal will have significant economic benefits, we believe they will result from lower search costs and better asset allocation.**

In analyzing the rule's likely costs and benefits, the Department states that plan participants will benefit because they will be able to make better investment decisions with lower search costs. We agree. The Department estimates that the benefits over a ten-year period (in today's dollars) could be \$6.9 billion to \$8 billion. These estimates seem plausible. However, we believe that these estimated benefits will stem in significant part from participants being better equipped to engage in knowledgeable asset allocation rather than an assumed reduction in fees.

In the Department's analysis, benefits arise from two sources. First, plan participants will spend less time searching for information about their funds. This source accounts for roughly two-thirds of the estimated benefits. The methodology on which this estimate is based appears reasonable and could, if anything, be conservative.<sup>32</sup>

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<sup>32</sup> For example, to estimate the benefits from plan participants spending less time searching for information about their plans, the Department assumes that the hourly value of plan participants' leisure time is \$31.3 per hour. This is based on an hourly wage rate of \$35 for private sector workers participating in a pension plan, which is then

Second, the Department assumes that plan participants will benefit from reductions in the fees that plan participants incur through their 401(k) plans. The Department bases this on its interpretation of academic literature as suggesting that 401(k) plan participants pay fees that are on average higher than necessary by 11.3 basis points per year. We believe that this assumption is based on a misreading of the literature cited, misinterpretation of the statistics presented, and may have failed to recognize empirical difficulties in some of those studies (see attached appendix).

We agree that better information, or information presented in a more understandable way for all investment products offered to participants, may result in some participants incurring lower investment fees. For example, participants now will be able to compare fees and expenses of all pooled investment products offered in the plan, while previously there was no requirement that participants receive information on annual operating expenses for products other than registered investment companies. Participants whose plans offer more than one investment option in a particular asset class may choose the lower cost option. But we know of no evidence that would allow one to conclude that 401(k) plan participants are systematically overpaying for the investments and services they receive.

Nevertheless, as noted, we believe that the Department's estimated benefits are plausible. Along with fee information, the proposal would provide participants with information on the investment type (*e.g.*, large cap, international equity), the risks of the investments, and the historical return of each designated investment option. This information will assist plan participants to make better investment decisions. Research shows that investments with equity exposure make a positive difference in generating retirement savings.<sup>33</sup> For those plan participants who may be too conservatively invested given their age and risk profile, the proposed disclosure could prompt them to re-allocate their portfolios. Previous

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reduced by 10 percent to adjust for the possibility that the opportunity cost of leisure may be less than observed wage rates for individuals. This 10 percent downward adjustment is based on a study by P. Feather and W.D. Shaw, "Estimating the Cost of Leisure Time for Recreation Demand Models," *Journal of Environmental Economics and Management*, 38(1), July 1999. It is possible that the Department relies on this finding in order to be conservative, which in our view is a sensible approach. However, the estimates in the Feather and Shaw paper are highly uncertain, are based on a small sample of individuals living in four states (Indiana, Nebraska, Pennsylvania, and Washington), and costs that individuals attach to a particular kind of recreation. In short, it is quite possible that an opportunity cost of leisure at \$35 per hour for private sector workers is perfectly appropriate. If so, the Department underestimates by 10 percent the benefits of reduced search costs by plan participants.

<sup>33</sup> See S. Holden and J. VanDerhei (2005) "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," *ICI Perspective*, Vol.11, No. 2 and *EBRI Issue Brief*, No. 283, Washington, DC: Investment Company Institute and Employee Benefit Research Institute, July 2005.

analysis conducted by the Institute shows that the majority of investors who have some exposure to equities will have accumulated more retirement assets at retirement than those with no exposure to equities.<sup>34</sup>

For example, according to Morningstar, the average annual return over the past decade for mutual funds that specialize in large blend domestic stocks is 5.2 percent. In contrast, the average annual return over the past decade for intermediate government bond funds is 1.3 percent. Plan participants who allocate their investments more efficiently based on the new disclosure are likely to reap higher returns over the long-term. Accordingly, we agree that the benefits of the disclosure regime that the Department has proposed justify its costs.

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The mutual fund industry is committed to meaningful ERISA disclosure. Over the past 30 years, the Institute has supported efforts to improve the quality of information provided to plans and participants and the way in which that information is presented. We strongly support the Department's proposal. If you have any questions, please contact the undersigned at 202-326-5826 or Michael Hadley at 202-326-5810.

Sincerely,

/s/ Mary S. Podesta

Mary S. Podesta  
Senior Counsel – Pension Regulation

Attachment

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<sup>34</sup> See letter from Brian Reid, Chief Economist, and Elena Barone, Assistant Counsel, Investment Company Institute, to Susan Dudley, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget, dated May 31, 2007. For example, a worker who begins investing at age 30 could expect, on average, to have more than twice the retirement assets at retirement by investing in a lifecycle fund with exposure to equities than in a stable value fund. Lifecycle funds performed better than stable value funds in the vast majority of cases, even for investors who began to make contributions later in life, when the lifecycle fund would be more conservatively invested with less exposure to equities.



**Appendix**  
**Assessing the Department of Labor’s Assumption that 401(k) Plan Participants  
Pay Fees that are Higher than Necessary**

The cost/benefit analysis in the Department of Labor’s rule proposal assumes that 401(k) plan participants “on average pay fees that are higher than necessary by 11.3 basis points per year.” We know of no evidence that would allow one to draw such a conclusion.

It is unclear how the Department reaches this 11.3 basis point figure. The Department cites a number of academic studies and industry studies in support of this estimate.<sup>1</sup> No such estimate appears in any of these studies and the Department provides no details on how it arrived at the 11.3 basis point estimate. Presumably, the Department calculated the 11.3 basis points from statistics presented in the studies it cites. If so, this calculation likely misinterpreted the statistics in those studies, misapplied some of those studies to 401(k) plans, and failed to recognize empirical difficulties inherent in some of those studies. In addition, the Department’s cost/benefit study failed to consider evidence showing that the mutual fund industry<sup>2</sup> is highly competitive.

While we agree that the rule the Department has proposed may result in some participants paying less in investment-related fees (although some may pay more if their asset allocation results in more equity exposure), there is no basis for concluding that plan participants systematically overpay for the investments and services they receive.

*Misinterpretation of Statistics Presented in the Literature Cited by the Department:* The Department’s cost/benefit analysis argues that dispersion in 401(k) fees implies market inefficiency.<sup>3</sup> As evidence, the Department points to a study by the Institute of average costs

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<sup>1</sup> The Department’s cost/benefit analysis cites six papers in support of its view that plan participants pay fees that are on average too high by 11.3 basis points: Brad M. Barber, Terrance Odean and Lu Zheng, “Out of Sight, Out of Mind, The Effects of Expenses on Mutual Fund Flows,” *Journal of Business*, 79(6), 2095-2119, 2005; James J. Choi, David I. Laibson, and Bridgette Madrian, “Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds,” NBER working paper W12261, May 2006; Deloitte Financial Advisory Services LLP, *Fees and Revenue Sharing in Defined Contribution Plans*, December 6, 2007; Edwin J. Elton, Martin J. Gruber, and Jeffrey A. Busse, “Are Investors Rational? Choices Among Index Funds,” NYU working paper, June 2002; Sarah Holden and Michael Hadley, “The Economics of Providing 401(k) Plans: Services, Fees, and Expenses 2006,” *Fundamentals*, 16(4), September 2007; and Jason Karceski, Miles Livingston, and Edward O’Neal, “Portfolio Transactions Costs at U.S. Equity Mutual Funds,” University of Florida working paper, 2004.

<sup>2</sup> The Department’s analysis and cited references appear to relate almost exclusively to mutual fund fees, and as a result (and because of the Institute’s expertise), our comments also relate to mutual fund issues. The Department’s analysis is incomplete because mutual funds represent only about half of the assets in participant-directed plans. We believe one benefit of the proposal is that participants will now be able to compare fees and expenses of all pooled investments.

<sup>3</sup> There is a “wide dispersion of fees paid in 401(k) plans. As supported by a report of the Investment Company Institute, the fees that plans pay vary over a wide range. According to their study, 23% of 401(k) stock mutual

incurred by participants in 401(k) plans (not “the fees that plans pay” as the Department suggests).<sup>4</sup> Figure 9 in the cited Institute study shows that the bulk (77 percent) of the 401(k) plan assets invested in stock mutual funds are invested in funds with expense ratios of less than 1 percent.<sup>5</sup> The remainder (23 percent) is invested in stock funds with expense ratios of 1 percent or more.

These percentages, however, say little, if anything, about market efficiency or whether plan participants overpay or underpay for the services they receive. The percentages are driven largely by the broad asset allocation decisions that plan participants make, not by whether plan participants pay too much or too little for a given type of fund. For example, nearly half of the 23 percent of 401(k) plan assets that are invested in stock funds with expense ratios of 1 percent or more are invested in international equity funds. International equity funds tend to be more costly to manage and therefore have higher expense ratios than domestic equity funds (especially large-cap domestic equity funds).<sup>6</sup> Plan participants who choose to invest in a mix of domestic equity and international funds will incur higher fees than participants who invest only in domestic equity funds, but they also expect to earn higher returns.

Dispersion in 401(k) fees can also reflect differences in plan services or characteristics, differences in employer subsidization of plans, and differences in arrangements for how plan participants and employers defray plan administrative costs. For example, as the ICI study discusses, the costs of running a 401(k) plan generally are shared by plan sponsors and participants and these arrangements can vary widely. Many employers voluntarily cover some or all of plan-related costs that plan participants would otherwise incur. Thus, an employer’s decision to pay a portion of plan costs can have a significant effect on the 401(k) plan fees charged to plan participants. Generally, when more plan costs are subsidized by employers, plan participants incur lower fees.<sup>7</sup>

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fund assets are in funds with expense ratios of less than 50 basis points, while an equal amount are in funds with an expense ratio of over 100 basis points. Some of this variation could be explained by varying amounts of assets in plans and their accompanying economies of scale. In addition, some plans might offer more, or more expensive, plan features. The Department believes, however, that a significant portion of the variation in plan fees is due to market inefficiencies.” 73 Fed. Reg. at 43020.

<sup>4</sup> See Sarah Holden and Michael Hadley, “The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006,” *Fundamentals*, Vol. 16, No. 4, September 2007 (hereinafter Holden and Hadley), available at <http://www.ici.org/pdf/fm-v15n7.pdf>.

<sup>5</sup> See Holden and Hadley, Figure 9, page 13.

<sup>6</sup> As evidence, see Figure 8 in Holden and Hadley, which shows that in 2006 the average expense ratio incurred by 401(k) plan participants for investing in foreign stock funds was 97 basis points, compared to 70 basis points incurred for investing in domestic stock funds.

<sup>7</sup> See, for example, Figure 4 in Holden and Hadley, which shows that about 40 percent of plan sponsors pay some or all 401(k) recordkeeping and administrative costs.

*Literature Cited Inapplicable to 401(k) Plans:* The Department states that a “review of the relevant literature suggests that plan participants on average pay fees that are higher than necessary by 11.3 basis points per year.” In support, the Department references six studies. Only two of these studies, those by the ICI and Deloitte Financial Advisory Services LLP, relate to 401(k) plans. The ICI and Deloitte studies provide evidence on the level of fees that plan participants pay, not whether they overpay or underpay for services received. To judge from these studies whether plan participants pay too much or too little, one would have to determine the “right” level of fees and services. Neither study does this, nor is it obvious how one would go about determining such a level.

The remaining four studies consider neither 401(k) fees nor the behavior of 401(k) plan investors. Two of the studies consider choices made by *load fund* investors.<sup>8</sup> A third study compares the fees charged by load and no-load S&P 500 index funds.<sup>9</sup> Since 401(k) plan investors do not generally incur load fees, these three studies would appear to be irrelevant. The fourth study examines brokerage fees incurred by equity mutual funds.

*Empirical Difficulties with the Studies Cited by the Department:* Putting aside the relevance of the studies cited by the Department, some of these studies have empirical issues that challenge the validity of their conclusions generally.

For example, the Department cites a study by Elton, Gruber, and Busse (2002) on the expenses of S&P 500 funds.<sup>10</sup> That study claims, on the basis of the expense ratios of S&P 500 funds available in the marketplace, that investors make irrational choices when selecting mutual funds. The ICI has previously disputed that claim,<sup>11</sup> showing that: (a) S&P 500 index funds are commodities in that they have essentially identical portfolios; (b) these funds nevertheless differ from one another in many respects; and (c) nearly all of the dispersion in the expense ratios of S&P 500 funds is explained by fund characteristics (such as fund size and investors’ average account balances) rather than by market inefficiency or investor irrationality.

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<sup>8</sup> Brad M. Barber, Terrance Odean and Lu Zheng, “Out of Sight, Out of Mind, The Effects of Expenses on Mutual Fund Flows,” *Journal of Business*, 79(6), 2095-2119, 2005; James J. Choi, David I. Laibson, and Bridgette Madrian, “Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds,” NBER working paper W12261, May 2006.

<sup>9</sup> Edwin J. Elton, Martin J. Gruber, and Jeffrey A. Busse, “Are Investors Rational? Choices Among Index Funds,” NYU working paper, June 2002.

<sup>10</sup> *Id.*

<sup>11</sup> See Sean Collins, Investment Company Institute, “Are S&P 500 Index Mutual Funds Commodities,” *Perspective*, Vol. 11, No. 3, August 2005.

In addition, Elton, Gruber, and Busse (2002) claim that a “large amount of new cash flow goes to the poorest-performing [S&P 500 index] funds.”<sup>12</sup> That is incorrect: over the ten year period 1998 to 2007, about 85 percent of the net new cash flowing to S&P 500 index funds went to the least costly funds, those with expense ratios of 20 basis points or less.<sup>13</sup> Elton, Gruber, and Busse (2002) appear to reach this inappropriate conclusion because they analyze flows *scaled by assets* rather than dollar flows. As a result, in their study, very small funds can have a disproportionate influence.

In addition, the paper by Barber, Odean, and Zheng (2005) is subject to alternative interpretations. Barber, Odean, and Zheng (2005) claim to have found that “[i]nvestors are more sensitive to salient in-your-face fees, like front-end loads and commissions, than [fund] operating expenses.” One statistic that Barber, Odean, and Zheng (2005) provide in support is that repeat buyers of front-end load funds tend to pay lower loads on subsequent purchases than on initial purchases, while repeat purchasers of all funds tend to pay nearly identical expense ratios on initial and subsequent purchase. Our view is that this says little about, if anything, about whether investors are sensitive to front-end loads and fund expense ratios. Instead, it simply illustrates how front-end load funds are priced: front-end load funds typically offer discounts on load fees when the cumulative dollar value of shares purchased exceeds a given dollar amount.<sup>14</sup>

Another issue is that some of the studies cited by the Department rely on samples that are representative of neither 401(k) plan participants, nor mutual fund investors in general. One of the studies—Barber, Odean, and Zheng (2005)—relies on a sample of load fund investors provided by a *single* brokerage firm. Another study cited by the Department—the study by Choi, Laibson, and Madrian (2006)<sup>15</sup>—relies on a survey that asks a relatively small number of individuals how they *would* invest in load funds, not how they do invest. It is unclear whether the surveyed individuals are 401(k) plan participants, whether they have any mutual fund investments, or any investments at all.

*The Mutual Fund Market is Highly Competitive:* Finally, the Department failed to cite studies indicating that the mutual fund industry is highly competitive. The textbook definition

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<sup>12</sup> Edwin J. Elton, Martin J. Gruber, and Jeffrey A. Busse, “Are Investors Rational? Choices Among Index Funds,” NYU working paper, June 2002, page 25.

<sup>13</sup> Investment Company Institute, *2008 Investment Company Factbook*, 48<sup>th</sup> edition, page 65.

<sup>14</sup> Thus, for example, an investor who initially invests \$25,000 and pays a front-load of 5.25 percent might expect to pay a front-load of just 3.00 percent on a subsequent purchase of \$25,000 in the same front-end load fund.

<sup>15</sup> James J. Choi, David I. Laibson, and Bridgette Madrian, “Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds,” NBER working paper W12261, May 2006.

of a competitive industry is one in which there are many firms, none of which has a dominant market share. Firms may freely enter or exit the industry, and consumers are free to vote with their feet. In a competitive industry, firms cannot overcharge and consumers do not “overpay.”

The mutual fund industry is “a classic, competitively structured industry, with hundreds of competing firms offering thousands of products, low barriers to entry ... and low concentration.”<sup>16</sup> About 600 advisers manage mutual fund assets in the United States. Competition has prevented any one firm from dominating the market. For example, of the largest 25 fund complexes in 1985, only 13 remained in this top group in 2007.<sup>17</sup> Other measures also indicate that the fund market is competitive. In 2007, for instance, the industry had a Herfindahl index (a standard measure of industry concentration) of 440; index numbers below 1,000 indicate that an industry is unconcentrated. In addition, competition in the fund industry is fostered by low barriers to entry. Indeed, the number of mutual fund advisers nearly tripled from 1984 to 2004.<sup>18</sup>

Fund investors are mobile: they can take their investments elsewhere if they feel a given fund’s fees are too high. To be sure, in a typical 401(k) plan, participants are limited to the menu of investments selected by plan fiduciaries. But plan fiduciaries can and do alter plan menus in order to replace poorly performing funds<sup>19</sup> and plan participants can select from among funds in a plan’s menu. There is considerable evidence that 401(k) plan participants invest in low cost funds. For example, although the fees of S&P 500 index funds exhibit considerable dispersion, nearly all (more than 90 percent) of 401(k) plan assets invested in S&P 500 funds are in the least costly of such funds (those with expense ratios of 20 basis points or less).

As we state in our letter, we agree that the Department’s proposed disclosure regime will have significant benefits. But there is no basis for concluding that plan participants systematically overpay for the investments and services they receive in their 401(k) plans.

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<sup>16</sup> John C. Coates IV and R. Glenn Hubbard, “Competition and Shareholder Fees in the Mutual Fund Industry: Evidence and Implications for Policy,” American Enterprise Institute, working paper #127, June 2006, page i.

<sup>17</sup> See Investment Company Institute, *2008 Investment Company Factbook*, 48<sup>th</sup> edition, page 21.

<sup>18</sup> See table 1 in John C. Coates IV and R. Glenn Hubbard, “Competition and Shareholder Fees in the Mutual Fund Industry: Evidence and Implications for Policy,” American Enterprise Institute, working paper #127, June 2006.

<sup>19</sup> See Deloitte Consulting, *401(k) Benchmarking Survey*, 2008 Edition, page 22. The report finds that 95% of responding plan sponsors evaluate and benchmark their plan’s investments at least annually, and that 64% have replaced a fund due to poor performance in the past two years.