Are Enhanced Fee Disclosure Rules Associated with Lower Fees?

Alison Shelton, The Pew Charitable Trust[1]

Introduction and Objectives

Fees charged to retirement savings accounts such as 401(k) plans have an important impact on final retirement savings balances. Even small fees can have a large impact. Over the span of 20 years, a portfolio of $100,000 earning returns of 4 percent, less annual fees of 0.5%, would reach almost $210,000. If the same portfolio were instead subject to fees of 1 percent, the portfolio value at the end of 20 years would be about $28,000 lower (US Securities and Exchange Commission, 2014). The largest component of plan fees is associated with managing plan investments. Other fees are often charged for recordkeeping, accounting, legal and trustee services, participant education, or to individual participants for executing investment directions or for taking advantage of the plan's loan or distribution features.

In 2012, new federal regulations increased transparency in fees disclosed to plan sponsors, and by plan sponsors to retirement plan participants. The final regulations affecting service provider disclosures to plan sponsors became effective on July 1, 2012 (Federal Register, 2012). Separately, the Department of Labor (DOL) issued new regulations on fee disclosures by plan sponsors to 401(k) plan participants; these new disclosures were to be provided to participants by the later of August 30, 2012, or 60 days after the service provider fees disclosures were due (Fiduciary Requirements, 2011). In particular, plan sponsors are required to provide six categories of investment disclosures to participants, with some of the disclosures (performance data, benchmark comparisons, and fee and expense information) provided in a comparative chart format (US Department of Labor, 2013).

Significance

We are not aware of other studies of the impact of the 2012 disclosure changes on plan fees.

Method

Using a database of 26,000 company retirement plans in 2009 and the plans' investment holdings, this paper examines the relationship between increased fee transparency in 2012 and the change in fees at the levels of employer/plan sponsors and individual plan funds over the period from 2009 through 2014. The data is a longitudinal aggregation of publicly available plan reports filed with the government and investment data and includes information on, among other things, type of retirement plan, investment options, asset levels, and plan costs. The data is limited to plans with at least 100 participants, and our sample is restricted to private sector retirement savings plans.

Given the lengthy federal rule-making process, many fund providers and plan sponsors were likely aware of the US Department of Labor's intention to revise fee disclosures before the rules were finalized in 2012. Mutual fund and other plan service providers may have adjusted their fund offerings to reduce fees in existing funds and/or offer new low-fee funds. Plan sponsors, increasingly aware of the role played by fees in employee wealth accumulation, may have been prompted to take a closer look at their own plan portfolios and even to address fees that were concerningly high. Participants may also have become increasingly aware of the importance of fees due to education by plan sponsors or advice from the financial industry in news platforms and other outlets. Or, participants may be largely unaware of the fees they pay on their retirement investments: a 2016 Pew survey of 3,000 workers found that only 25 percent of respondents with

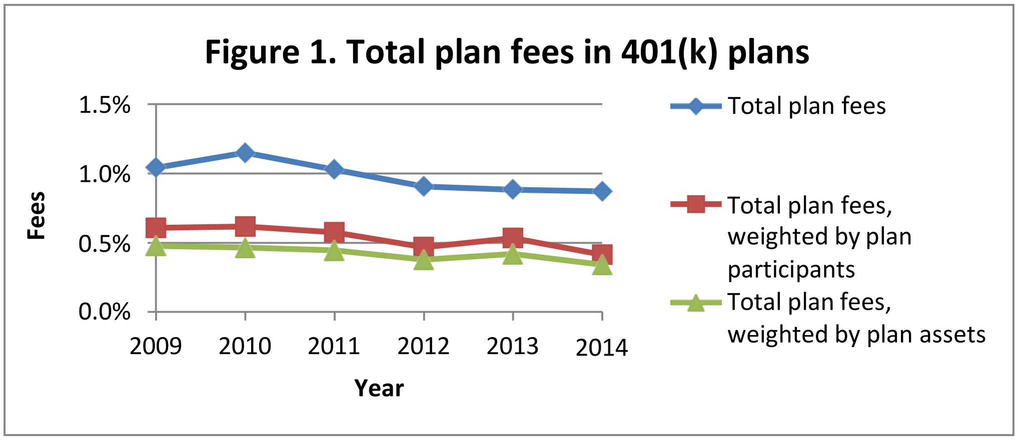
[1] Research Senior Officer, Retirement Savings Project, 901 E. Street NW, The Pew Charitable Trust, Washington, D.C., 20004, USA. Phone: 202-540-6678. Email: ashelton@pewtrust.org.

retirement plans said they had read *and* understood a disclosure about retirement account fees (Pew Charitable Trust, 2017).

In addition to descriptive analysis, we will use regression analysis to model changes in plan fees over time, with a focus on the key explanatory variable of policy implementation, both in terms of total plan costs as well as for specific fees such as investment management fees. The analysis also uses a number of controls including type of retirement plan, the number of plan participants, the number of investment options, use of index funds or target date funds, assets allocated to investment options, and employer characteristics. We will also look at the prevalence of high-cost funds in plans as an outcome, including the probability that such funds were dropped over time.

Preliminary Results

Figure 1 presents the average total plan fees of 401(k) plans in the dataset using different weights. The top line (total plan fees) is a simple average of plan fees across all plans. Participant and asset weights are also used because the average plan tends to be small, but participants and assets tend to be concentrated in larger plans. Larger plans tend to have lower total fees as a percent of plan assets, due to economies of scale and also because larger plans tend to have a greater share of assets invested in index funds (Investment Company Institute, 2014). Total plan fees, under all weighting schemes, decline by 0.1-0.2 percentage points from 2010 to 2012. After 2012, fees decline more slowly, or even rise temporarily.



References

Employee Benefits Security Administration. (2011). Fiduciary requirements for disclosure in participant-directed individual account plans. Retrieved from https://www.gpo.gov/fdsys/pkg/CFR-2011-title29-vol9/pdf/CFR-2011-title29-vol9-sec2550-404a-5.pdf

Federal Register. (Feb. 3, 2012). The new regulations amended §408(b)(2) of the Employee Retirement Income Security Act of 1974, as amended (ERISA). Retrieved from at https://www.gpo.gov/fdsys/pkg/FR-2012-02-03/pdf/2012-2262.pdf

Investment Company Institute (2016). The brightscope/ici defined contribution plan profile: A close look at 401(k) plans, 2014. Retrieved from: https://shrm.org/ResourcesAndTools/hr-topics/benefits/Documents/ppr_14_dcplan_profile_401k.pdf

Pew Charitable Trusts. (2017). Many workers have limited understanding of retirement plan fees.

US Department of Labor. (2013). A look at 401(k) plan fees. Retrieved from: https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/publications/a- look-at-401k-plan-fees.pdf

US Securities and Exchange Commission. (2014). How fees and expenses affect your investment portfolio. SEC Pub. No. 164. Retrieved from: https://www.sec.gov/investor/alerts/ib_fees_expenses.pdf