Statement on 401(k) Fee Disclosure Act
Senator Tom Harkin
December 13, 2007

Mr. PRESIDENT. I am here today to introduce, along with Senator Kohl, the Defined Contribution Fee Disclosure Act. This legislation is designed to address what may seem at first glance like a small issue, but in fact has a dramatic impact on the retirement security of millions of Americans who have 401(k) plans. Not many people realize this, but the Employee Retirement Income Security act (ERISA) does not require plan sponsors to provide participants with information on the level of fees that participants are charged by the various plans they have to choose between.

The number of people participating in defined contribution plans grows every year, and unfortunately, these plans are a bigger part of their nest egg as employers freeze their defined benefit plans. One of the key challenges as we move away from guaranteed benefits is making sure people have all the relevant information to help them decide which plan will best serve their needs. Recently, AARP conducted a survey in which it asked individuals with 401(k) plans if they even knew what they paid each year in fees. Only 17% of people asked (Chart 1) said that they know what their fee levels were.

This is far from an academic matter. In fact, this could be disastrous for folks when they reach retirement. One person – who wishes to remain anonymous – recently shared with me a story that highlights what’s at stake. She noticed one day that her 401(k) wasn’t actually earning anything at all. After some examination, she found that the agent who set up the plan for the company received a fee of 2 percent annually for the first five years, reduced to .25 percent after that, paid by the employees and not the company. The investment firm charged a fee of 1.25 percent (which they said was standard for companies with under $1 million in their 401ks). So, last year, she was paying 3.25 percent in fees and earning less than 4 percent from her money market fund. She didn’t have a clue about the fees until she inquired after she realized she wasn’t making any money on the fund.

So looking back at this AARP survey, of those 17% who said they knew what their fees were, 33% thought they weren’t being charged any fees at all. Some companies will even tell people they aren’t being charged fees. While it is true that in some cases, employers pay fees, that is hardly the norm. And investment managers don’t do their jobs for charity. And these fees that people don’t know about can have a big effect on what they end up with at retirement.

The U.S. Government Accountability Office (GAO) recently estimated that a 45 year old with $20,000 in his 401(k) would have $70,555 at age 65 for his retirement, assuming he was getting a 6.5% return and only paying 0.5 percent in fees. But that figure decreases dramatically if the fees are increased by just a single percentage point, to 1.5 percent. At that figure the same individual, investing the same amount of money, would have only $58,400 for his retirement, or more than $12,000 less.

AARP took the GAO assumptions and created some additional examples. Consider this case: if a 35 year invested $20,000 in a 401(k) plan over 30 years, paying 0.5 percent in fees, that individual would have $132,287 for retirement. But increase the fees to 1.5 percent, and the amount available for retirement is only $99, 679 – that is a 25 percent reduction in the account balance. Even if the fee only increased from 0.5 percent to 1 percent, the value of the retirement account would be reduced by $17,417, or a little over 13 percent over the 30-year period.

Mr. President, if you awoke one day to find that your banking account, or your retirement account, had declined in value by 25 percent, you would understandably be alarmed, and you would act quickly to fix the problem. But with high 401(k) fees, the reduction in benefits isn't immediately obvious. (Chart #3) It happens slowly, over time, and often flies under people's radar screens because they aren't told the level of fees they are paying, or they don't understand that some 401(k) plans charge far lower fees for providing the same amount of services. It is that problem – that information gap – that the Defined Contribution Fee Disclosure Act is designed to fix.

My bill would provide participants with easily understandable information about the fees that they are paying. This information will be provided to them before they pick which plans they want to invest in, and again, regularly, on their quarterly statements.

In addition, this bill does something even more important: it would require companies to disclose more information to plan sponsors. Right now, if you provide your workers with a 401(k) plan, you are required to act prudently and in their sole interest in your fiduciary duties. However, there are hidden fees that are sometimes not disclosed even to plan sponsors, and sometimes those sponsors also aren't told about business arrangements between service providers to steer participants into investment options in which they have a stake, a classic conflict of interest.

To fix this, the bill would require 401(k) plan providers to disclose all fees and relationships between service providers to the people selecting the plan a company will ultimately offer. The bottom line is that we want to create a situation where companies are picking several good options for their employees that all have decent reliable returns and fair fees.

One thing my bill does not do is set a limit on fees that can be charged. As I've noted, high fees can make a real difference in account balances at retirement, but so can high returns, in a more positive direction, obviously. Sometimes, it is well worth paying higher fees if a small increase in fees will have a big effect on returns. In addition, some people want to purchase insurance products so that every month, they are buying a more secure piece of retirement. That's just fine, and my bill doesn't touch that. People who fully understand the real cost of a guaranteed return at retirement are the kind of people who appreciate, and will push for, more defined benefit plans. But they can't do that if they don't know what it costs.

The bottom line is that people need to be investing more, and more confidently, in the 401(k) plans they are being offered. This is especially critical in a world where defined benefit plans are increasingly being slashed and frozen. For a growing number of workers, their only source of retirement income is their 401(k).

Congress needs to focus more squarely on how we get workers to participate in the plans they have available, and what we can do to make sure the savings they grow in them are adequate. When people know they are being given all the facts in an easy-to-understand manner, they are more likely to contribute. And when the fiduciaries who are supposed to be looking out for them make sure all of their options are good, they end up saving more money at the end of the day.

This bill is a win for companies who want to provide their workers with a secure retirement, it is a win for 401(k) providers who have been providing reasonable fees all along, and it is a win for every American who has one of these plans. My colleagues and I introducing this measure have worked with interested parties on every side of this issue to make sure we're taking into account everyone's views. We also intend to work closely with the Department of Labor on their proposed regulations on this issue. While we believe that Congress has an obligation to address this issue, if we can all work together to develop regulations that address this issue in a way that will truly help participants and beneficiaries get a good deal, I am certainly not opposed to getting this done administratively. I strongly encourage my colleagues to cosponsor this measure.