U.S. 401(k) Disclosure Is Coming - What To Do In January

December 21, 2011 by Carol Buckmann

In prior blog posts, (see posts from October 26, 2010 and July 15, 2011) I have described new participant fee and investment disclosure requirements that will apply to 401(k) plans and other participant-directed defined contribution plans beginning May 31, 2012. Many participants will learn for the first time the fees they are paying for services such as investment management, custody and record-keeping when the new regulations become effective.

I can't overemphasize the importance of advance preparation in complying with these new technical requirements, such as providing participants with comparative investment charts showing historical investment returns and with glossaries of standard investment terms. In the process of preparing for the new disclosure, plan sponsors also are learning more about the fees associated with their investment offerings. As a result, investment line-ups are being re-shuffled.

Fidelity Investments recently posted a Reuters article on its website, indicating that many plan sponsors, as the Department of Labor hoped, have been taking a closer look at their investment options and fees in advance of the deadline for initial disclosures and taking more direct action to prepare and control what must be disclosed. According to the article, plan sponsors have been cutting back on the number of mutual fund offerings and trying to lower their fees by seeking lower fee solutions.

David Wray, the president of a 401(k) advocacy group, stated: "This is dramatic. I have not seen anything like this in 25 years of working with plan sponsors." And the statistics back him up. His group's survey indicated that fiduciaries of 63.8% of 401(k) plans changed investment options in 2010, compared to 20% in 2009. The article indicates that Brightscope, a research firm, has reported that average fees fell 0.11 percentage points between 2007 and 2009, a period in which these regulations were issued in proposed form and fees were being challenged in class actions and the subject of proposed disclosure legislation.

Here are some practical recommendations for fiduciaries seeking to change their investments and fees before the disclosures become mandatory:

- Know what your fund management fees are and make sure to investigate whether institutional class fund shares, which typically have lower fees, are available for your plan. David Hurley of Investment Consultants states in the article that investment management fees may represent as much as 90% of 401(k) costs.
- Provide an investment menu with a manageable array of funds. It is not advisable to simply make all of the funds in a mutual fund family available to participants. There will be a mix of high and low performing funds in the platform offered and these may have different fee levels. Plan sponsors report that many participants are likely to be overwhelmed by too much choice. In addition, fiduciaries will have difficulty demonstrating that they fulfilled their fiduciary responsibilities to select appropriate funds if they do not review and winnow down fund family offerings.
- Many fund families will let your plan use outside funds. Investigate their performance and fees.
- Offer low-fee index funds as an option.
- Consider whether your participants pay commissions, loads and other costs of investment. Transaction costs as well as your administrative and record-keeping costs may be negotiable. Fund sponsors often waive loads for 401(k) and pension accounts.
- Consider undertaking a request for proposal from new service providers, if your provider's fees are high, particularly if you haven't done an RFP recently.

- Consider hiring an outside adviser if your in-house expertise is limited.

However, it is also important to remember that fees are only one factor to consider in fulfilling fiduciary responsibilities. Performance and level of service should be weighed as well, and a fund with outstanding performance may be worth higher fees.