

Clear Participant 401k Fee Communication is Inevitable and Necessary

By Dennis Ackley

Participants in 401k plans deserve to know exactly how much of their money is paying for their funds and services. It's best for them and the retirement industry.

Most participants think 401ks are free. That's probably because employees are accustomed to seeing price tags on things they buy – 401ks don't have price tags. A recent AARP survey found that 65 percent of 401k participants believed they *pay no fees* for their investments. Another 18 percent don't know if they pay. None of this comes as a surprise to industry leaders.

Why hasn't the industry gotten ahead of this issue?

Most likely, some form of government-mandated participant fee disclosure is coming soon. Employees will find out 401ks have never been free. Their reaction won't be good...“If you didn't shoot straight with us about fees until the government made you, what else are you not telling us?” Lack of employee trust is bad for 401ks – and the retirement industry.

Isn't much of the reason 401k fees have been hidden (at least not highlighted) simply historical – because that's the way it's always been done? In the middle of the last century, retail-mutual-fund-companies expressed fees as 'expense ratios' and 'basis points.' Perhaps back then the sophisticated buyers of mutual funds realized that was jargon for 'fees'?

When retail funds were brought into 401ks in the 1980s, the retail jargon came with them. The funds got the Department of Labor generally to go along with using the fund prospectus to disclosure 'fees'.

The funds were not trying to do anything bad. They wanted to keep their costs down by using same approach they used in the retail market.

Today, in the reinvented retirement world, the industry still uses the same pricing scheme – although it was never intended to be highlighted or explained clearly. And it was not created with the idea of using it in employer-sponsored plans...or explaining fees in a manner that typical employees would understand.

If the structure is too hard to explain, why not change it?

Many in the retirement industry say it will be expensive to calculate exact fees for individuals under the current pricing method – that will add to the cost participants pay. They say it will also be difficult to explain the complicated charges. No doubt, all that's true. And it's probably why some in the industry would prefer to show participants estimates rather than exact charges.

But in the post-Enron era – with elections on the way – is now a good time to tell the government (politicians) that the industry does not want employees (voters) to know exactly how much they pay for their 401ks?

No one in the industry wants to hear a politician who's looking for votes say, “I'll force those multi-million dollar a year fund managers who are taking money out of your 401k everyday – even when your account goes down – to tell you exactly how much of your money they're taking. And in the bill I submit, I'll put a cap on how much they can take from your account. And I'll make them offer you funds at the same price federal employees pay.”

Exaggerated? Hopefully – but why take the risk?

For employer-sponsored plans, the retirement industry needs a pricing system that is simple and transparent – like other service industries have.

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Showing fee estimates won't make the issue go away. Ask plan sponsors if they think engineers, architects, and other analytical employees would be satisfied with estimates. Most likely, people who are accustomed to dealing with precision will demand accuracy.

Most plan sponsors want their employees to become 'retirement consumers.' One way to do that is to show them exactly how their 401k costs and explain the value they receive for what they're paying. Maybe if they realized they were 'buying' the funds, they'd take more interest in their 401ks?

And if 401k fees are as competitive as the funds say – and they probably are – then shouldn't employees be shown the fees and some benchmarks to prove what a great bargain they're getting?

It's not certain that all employees will simply select the lowest cost fund. Some of them may assume that the more expensive funds are the better funds. Getting employees to ask why the prices vary and what can be expected from higher-priced or lower-priced funds may provide them with a valuable learning experience. Naturally, pilot testing should be done to better understand the ramifications. But that's never been done in any aspect of 401ks – including their likelihood of providing adequate retirement income.

Some government officials want employees to see a breakout out of various 401k costs. But the focus should be on the customer, not on the process. Just because the cost of the various 401k services or products can be broken out isn't a reason to show it to participants. The price tag of a gallon of milk could show the cost of transporting it to the store. But would that help consumers make better decisions?

Isn't there another good way to price the services?

Rather than defend a half-century-old pricing approach that was invented to serve sophisticated investors who had defined-benefit plans, maybe it's time for a new one? Haven't most other types of service providers reinvented their fee structure every few years?

The fund industry is full of smart people. They can develop a new pricing approach for 401ks that's easy for participants to understand.

What if a provider/recordkeeper could figure out how to run its business by charging the same price for all the funds offered? That would be easy to explain. And it might help support the 'level compensation' option under the Pension Protection Act's advice provisions. If that won't work, how about borrowing the cable TV fee approach? Let's say a flat monthly amount is charged for 'basic services and funds' and extra amounts for any 'premium funds' the employee selects. Or how about using ideas from hundreds of other models? Is the current approach the only one that will work?

For employer-sponsored plans, the retirement industry needs a pricing system that is simple and transparent – like other service industries have. Any approach that appears to be an attempt to hide fees will not strengthen the industry. And Americans need strong retirement industry. The alternatives aren't good.



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Dennis Ackley

Dennis Ackley is a nationally recognized leader in benefit communication and retirement education. His innovative, award-winning communication programs have reached more than three million employees on topics such as retirement planning, investing, health care, benefit choices, pay, and incentive plans. Dennis has created communication campaigns for hundreds of the country's largest employers. He has written more than four dozen articles for such publications as *HR Magazine*, *Benefits Quarterly*, *Employee Benefits News*, and *Communication World*. He is a featured speaker at scores of conferences including the International Foundation of Employee Benefit Plans, Profit Sharing/401(k) Council, the PBGC, The Conference Board, Pensions & Investments, and Benefits Management Forum and Expo.

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