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The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2012

KEY FINDINGS

- **401(k) plan participants in mutual funds tend to hold lower-cost funds.** At year-end 2012, 401(k) plan assets totaled $3.6 trillion, one-third of which was invested in equity mutual funds. In 2012, the average expense ratio on equity funds offered for sale in the United States was 1.40 percent. 401(k) plan participants who invested in equity mutual funds paid less than half that amount, 0.63 percent.

- **The expenses that 401(k) plan participants have incurred for investing in mutual funds have declined substantially in the past 15 years.** In 1998, 401(k) plan participants incurred expenses of 0.74 percent of the 401(k) assets they held in equity funds. By 2012, that had fallen to 0.63 percent, a 15 percent decline. The expenses 401(k) plan participants incurred for investing in hybrid and bond funds have fallen even more, by 19 percent and 23 percent, respectively, from 1998 to 2012.

- **The downward trend of 401(k) plan participants incurring lower expense ratios in mutual funds continued in 2012.** The expense ratio 401(k) plan participants incurred for investing in equity mutual funds declined from 0.65 percent in 2011 to 0.63 percent in 2012. Expense ratios that 401(k) plan participants incurred for investing in hybrid funds fell from 0.61 percent in 2011 to 0.59 percent in 2012. The average expense ratio 401(k) plan participants incurred for investing in bond mutual funds dropped from 0.52 percent in 2011 to 0.50 percent in 2012.

- **401(k) plans are a complex employee benefit to maintain and administer, and they are subject to an array of rules and regulations.** Employers offering 401(k) plans typically hire service providers to operate these plans, and these providers charge fees for their services.

- **Employers and employees generally share the costs of operating 401(k) plans.** As with any employee benefit, the employer typically determines how the costs will be shared.

INVESTMENT COMPANY INSTITUTE®

Why Employers Offer 401(k) Plans

During the past three decades, 401(k) plans have become a popular workplace benefit, valued for their role in providing employees a means to set aside a portion of their compensation on a tax-favored basis. Indeed, 401(k) plans have become the most common defined contribution (DC) plan, holding $3.6 trillion in assets at year-end 2012 (Figure 1).[1] In the past two decades, mutual funds have become a primary provider of 401(k) plan investments, with the share of employer-sponsored 401(k) plan assets held in funds increasing from 9 percent in 1990 to 60 percent at year-end 2012.

Employers that decide to offer 401(k) plans, an optional employee benefit, are confronted with two competing economic pressures: the need to attract and retain qualified workers with competitive compensation packages, and the need to keep their products and services competitively priced. As a firm increases overall compensation to its employees, it increases its ability to hire and retain workers, but it also increases the costs of producing its products and services. To provide and maintain 401(k) plans, employers are required to obtain a variety of administrative, participant-focused, regulatory, and compliance services. All of these services involve costs; generally, the plan sponsor and the plan participants share these costs.

Paying for 401(k) Plan Services

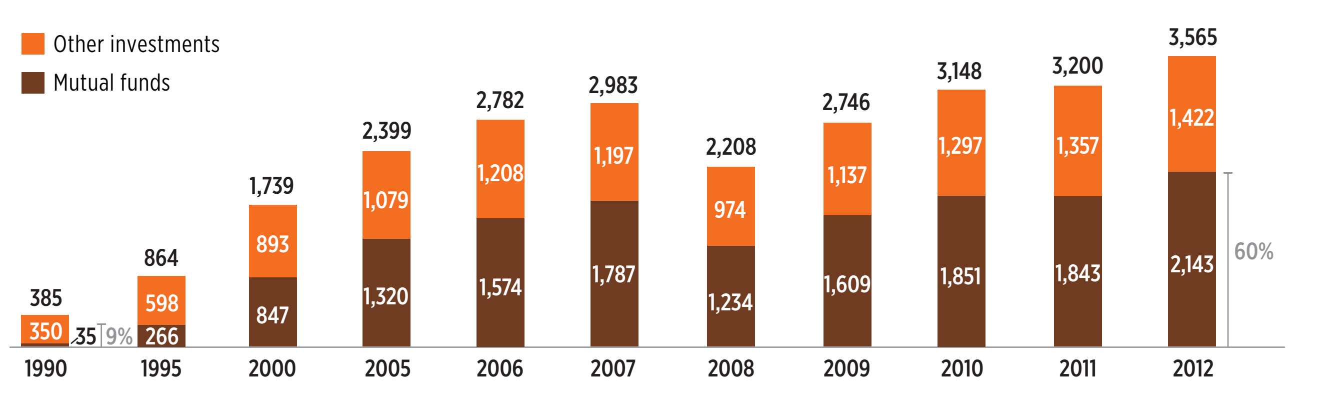
401(k) Plans Are Strictly Regulated

401(k) plans are complex to maintain and administer, and they are subject to an array of rules and regulations that govern their operation, including Section 401(k) of the Internal Revenue Code (IRC), which serves as the basis for their tax-favored treatment.[2] The Department of the Treasury and the Internal Revenue Service (IRS) enforce the tax code and impose numerous requirements that plans must satisfy in order to qualify for special tax treatment.[3] Furthermore, the plans must meet many statutory and regulatory requirements under the Employee Retirement Income Security Act of 1974 (ERISA), enforced by the Department of Labor (DOL).

FIGURE 1

401(k) Plan Assets

Billions of dollars, selected years



Note: Components may not add to the total because of rounding.

Sources: Investment Company Institute, Federal Reserve Board, and U.S. Department of Labor

401(k) Plan Sponsors Provide Certain Services

When an employer offers a 401(k) plan to its employees, it selects an individual or group of individuals, known as plan fiduciaries,[4] to oversee the administration of the 401(k) plan for the exclusive benefit of plan participants, consistent with the terms of the plan and ERISA. The plan fiduciaries must arrange for the provision of the many services required to create and maintain a 401(k) plan.

Administrative services. These services maintain the framework of a 401(k) plan and include recordkeeping functions, such as maintaining plan and participant records and the creation and delivery of plan participant account statements (Figure 2). DOL regulations require plans to allow participants to make changes to their investment elections at least quarterly,[5] but most 401(k) plan participants are permitted to make daily transactions in their plans.[6] Administrative service providers support these activities, processing each and every participant transaction. In addition, plan fiduciaries must arrange for administrative services relating to setting up, converting, or terminating a plan, as well as trustee services.[7]

Participant-focused services. These services are geared toward helping employees fully achieve the benefits of their 401(k) plans. Sponsors provide participants with a wide array of communications, educational resources, and advice services to assist in investment and retirement planning (Figure 2).[8] In addition, the plan fiduciaries select a lineup of professionally managed investment options that typically cover a range of return and risk,[9] sometimes including a brokerage window through which participants may select securities not in the plan's lineup. If a 401(k) plan sponsor chooses to permit loans, plan fiduciaries must arrange for loan processing services. In addition, plans may opt to provide participants with access to annuity purchasing services at the time of retirement.

Regulatory and compliance services. These services ensure that a plan fulfills legal requirements imposed by statute, DOL and IRS regulations, and other guidance (Figure 2). Plans are subject to complicated restrictions on contributions,[10] lengthy audited annual reports to the DOL,[11] and tax reporting to the IRS. Plans may have additional compliance burdens under federal securities or state laws.[12] Furthermore, each particular investment option used in a plan has its own compliance requirements. For example, mutual funds must comply with the Investment Company Act of 1940 and other securities laws,[13] bank collective trusts with banking regulations, and group annuity contracts with state insurance rules.

Plan Sponsors Must Ensure That Service Costs Are Reasonable

By law, plan sponsors have a "responsibility to ensure that the services provided to their plan are necessary and the cost of those services is reasonable."[14] In February 2012, the DOL released regulations concerning the fee and compensation information that plan sponsors must collect, and service providers must disclose, to ensure that a contract or arrangement for services is considered "reasonable" under ERISA.[15] DOL's goal for this regulation, which became effective in July 2012, is to help ensure that plan sponsors can make informed decisions about important plan services and their costs and to reveal any potential conflicts that a service provider might have.[16] Fees are only one factor among many that a plan sponsor must consider, along with the extent and quality of service and the characteristics of the investment options chosen.[17]

The DOL also released a regulation in October 2010 that requires plans to give participants, when they become eligible for the plan and annually thereafter, key information about the plan's investments and fees.[18] DOL's goal is to ensure that 401(k) participants have the information they need to make decisions such as whether to participate in the plan and how to allocate the assets in their accounts among the investments available.

FIGURE 2

Services Provided to 401(k) Plans

Administrative services:
Recordkeeping, including maintaining plan records; processing employee enrollment; processing participants' investment elections, contributions, and distributions; and issuing account statements to participants
Transaction processing, including purchases and sales of participants' assets
Plan creation/conversion/termination, requiring administrative services
Trustee services, providing the safe holding of the plan's assets in a trust, as required by ERISA
Participant-focused services:
Participant communication, including employee meetings, call centers, voice-response systems, web access, and preparation of summary plan description and other participant materials
Participant education and advice, including online calculators and face-to-face investment advice
Investment management, typically offered through a variety of professionally managed investment options
Brokerage window, if offered, allowing direct purchase of individual securities by plan participants
Maintenance of an employer stock fund, if offered, to facilitate the purchase of employer securities within the plan
Loan processing, if a loan feature is offered
Insurance and annuity services, if offered, including offering annuities as distribution options
Regulatory and compliance services:
Plan document services, including off-the-rack "prototype" plans
Consulting, including assistance in selecting the investments offered to participants
Accounting and audit services, including preparation of annual report (Form 5500)
Legal advice, including advice regarding interpretation of plan terms, compliance with legal requirements, plan amendments, and resolution of benefit claims
Plan testing, to comply with Internal Revenue Code nondiscrimination rules
Processing of domestic relations orders, ensuring that the split of accounts pursuant to divorce orders complies with ERISA

Sources: Investment Company Institute and U.S. Department of Labor

Plan Sponsors Select Service Providers and Investment Arrangements

Plan sponsors select the service providers and choose the investment options offered in their 401(k) plans.[19] The costs of running a 401(k) plan generally are shared by the plan sponsor and participants, and the arrangements vary across plans. The fees may be assessed at a plan level, participant-account level, as a percentage of assets, or as a combination of arrangements.

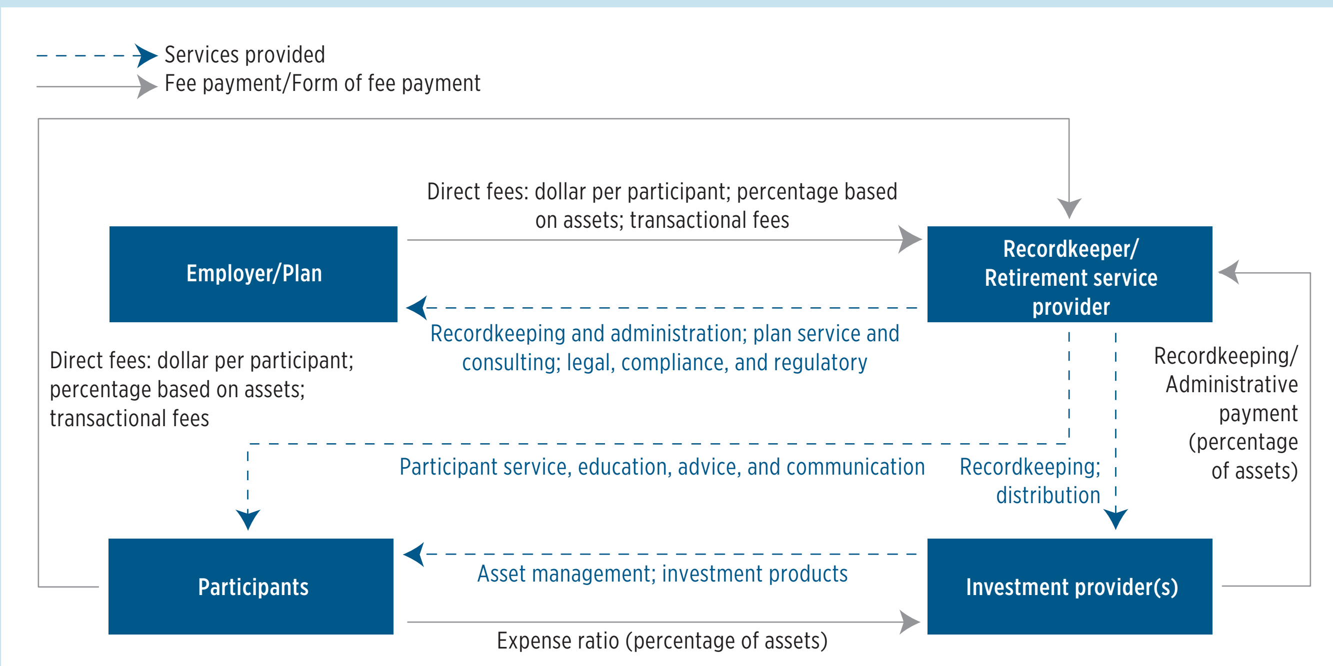
Figure 3 presents a schematic of possible fee and service arrangements in 401(k) plans. As shown in the boxes on the left side, employers, plans, and participants consume services in 401(k) plans. The boxes on the right side highlight the recordkeeper or retirement service provider and investment provider that deliver the investment products or investment management services or both. The dashed arrows indicate the services provided. For example, the investment provider offers investment products and asset management to participants, while the recordkeeper provides services to the plan as well as to the participants.

The solid arrows illustrate the payment of fees for the services and products. Participants may pay directly for recordkeeping services, or the plan or employer may pay directly for such services. Participants may pay indirectly for recordkeeping services through fund expenses reflected in investment expense ratios (solid arrow from participants to investment providers) if the investment provider covers some recordkeeping/administrative expenses by sending payment to the recordkeeper (solid arrow at the far right) for recordkeeping services rendered (dashed arrow between recordkeeper and investment provider).

The DOL requires that the plan sponsor pay the costs associated with the initial design of the plan, as well as any design changes.[20] Beyond these design services, employers can share the costs of the plan services with their employees. However, many employers voluntarily cover some or all plan-related costs that legally could be shouldered by the plan participants. Any costs not paid by the employer, which may include administrative, investment, legal, and compliance costs, effectively are paid by plan participants.[21]

FIGURE 3

A Variety of Arrangements May Be Used to Compensate 401(k) Service Providers



Note: In selecting the service provider(s) and deciding the cost sharing for the 401(k) plan, the employer/plan sponsor will determine which combinations of these fee arrangements will be used in the plan.

Source: Investment Company Institute

A Means to Compare: The "All-In" 401(k) Plan Fee

As illustrated by Figure 3, there are a variety of fee arrangements in the 401(k) plan arena, with fees possibly being assessed per plan, per participant, or per dollar invested (asset-based fees). In addition, the fees may be paid by the plan sponsor (the employer), the plan, or the plan participants. To compare fees across plans, it is necessary to construct a measure—an "all-in" fee—that converts this array of arrangements into a single number for each plan. Constructing such an all-in fee as a percentage of plan assets permits comparison across plans, which is necessary to determine the key factors that influence plan fees.

Because fees are affected by a variety of factors, a range of fees is found across 401(k) plans. For example, a Deloitte/ICI survey of 525 DC plans in late 2011 (see page 7) found that plan size was a key driver of the all-in fee.[22] Specifically, plans with more participants and larger average account balances tended to have lower all-in fees than plans with fewer participants and smaller average account balances. This observed effect likely results in part from fixed costs required to start up and run the plan, much of which are driven by legal and regulatory requirements. It appears that economies are gained as a plan grows because these fixed costs can be spread over more participants, a larger asset base, or both. In addition, plans with lower allocations to equity investments tended to have lower fees compared with plans with higher allocations, reflecting the lower expense ratios associated with fixed-income investing compared with equity investing.

Lower all-in fees also were associated with plans where the participants and plan sponsor made a strong commitment to saving, through either higher participant contribution rates or the use of automatic enrollment. Plans with more investment options, however, tended to have higher all-in fees. As plans add more investment options, the additional investment options tend to be more specialized equity investments, which tend to have higher investment expense ratios.

Other factors were examined but found to have a minimal impact on the all-in fee. For example, the number of payrolls and the number of business locations did not significantly affect the all-in fee. The type of service provider (e.g., mutual fund company, life insurance company, bank, third-party administrator), the size of the service provider's platform (in terms of number of participants), and the length of relationship with the service provider were each analyzed and did not appear to have a significant impact on the all-in fee. Finally, the percentage of plan assets invested in proprietary investment products (the investment products of the service provider) did not appear to have a significant impact on the all-in fee.

About the Deloitte/ICI Defined Contribution Plan/401(k) Fee Study

As part of an ongoing comprehensive research program, the Investment Company Institute engaged Deloitte to carry out a survey of DC plan sponsors to shed light on how fee structures work within the DC plan market. In late 2011, Deloitte conducted a web-based survey of DC plan sponsors to update a similar survey effort in 2009. Specifically, the research addressed:

- the mechanics of plan fee structures;
- components of plan fees; and
- primary and secondary factors that affect fees ("fee drivers").

Due to the variety of fee and service structures that exist in the DC/401(k) market, the study created an analytical tool—the "all-in" fee—that seeks to represent the total of administrative and investment-related fees for each plan.

The all-in fee incorporates all administrative, recordkeeping, and investment fees whether assessed at a plan level, participant-account level, or as an asset-based fee, across all multiple parties providing services to the plan—whether they are paid by the employer, the plan, or the participants. The all-in fee excludes participant activity–related fees that only apply to particular participants engaged in the activity (e.g., loan fees). In addition, the all-in fee does not evaluate the quality of the products and services provided.

In total, 525 DC plans participated in the 2011 survey, providing detailed information regarding plan characteristics, design, demographics, products, services, and their associated fees. While the survey is not intended to be a statistical representation of the DC/401(k) marketplace, the demographics of the plans participating in the survey appear to be similar to the broader DC plan market (in terms of average account balance, number of investment options, average participant contribution rate, asset allocation, and plan design). Since the distribution of plans within the sample differs from the distribution of all 401(k) plans, to estimate industrywide fees, the survey responses were weighted by plan size to align with the universe of 401(k) plans reported by the Department of Labor.

The survey results are reported in ***Inside the Structure of Defined Contribution/401(k) Plan Fees: A Study Assessing the Mechanics of the "All-In" Fee,*** available at www.ici.org/pdf/rpt_11_dc_401k_fee_study.pdf.

Looking at Fees and Expenses of Mutual Funds Held in 401(k) Accounts

Virtually all participant-directed 401(k) plans offer a variety of pooled investment options (such as a selection of mutual funds, collective trusts, and/or separately managed accounts), but some also include guaranteed investment contracts (GICs),[23] company stock,[24] or a brokerage window that provides participant access to direct investment in stocks, bonds, and other securities.[25] All told, more than half (60 percent) of the $3.6 trillion in 401(k) plan assets at year-end 2012 was invested in mutual funds (Figure 4).[26] Mutual funds are required by law to disclose their fees and expenses and, as part of ongoing research, ICI studies trends in those fees and expenses.[27] In addition, ICI separately tracks 401(k) plan account holdings of mutual funds.[28] This report combines the results of these analyses in order to examine the fees and expenses that investors incur on mutual funds held in 401(k) accounts.[29] This analysis finds that:

- 401(k) plan participants tend to be invested in lower-cost mutual funds.
- At year-end 2012, 84 percent of mutual fund assets in 401(k) plans were held in no-load funds.
- Fifteen percent of mutual fund assets in 401(k) plans were held in load funds, predominantly in fund share classes that do not charge retirement plan participants a front-end load.

Investors Pay Two Types of Mutual Fund Fees and Expenses

Investors in mutual funds potentially can incur two primary types of fees and expenses when purchasing and holding mutual fund shares: sales loads and mutual fund expenses. Sales loads are one-time fees paid either at the time of purchase (front-end loads) or, in some cases, when shares held less than a specified number of years are redeemed (back-end loads, also known as contingent deferred sales loads or CDSLs). Mutual fund expenses include ongoing charges for portfolio management, fund administration, and shareholder services, as well as fund distribution charges, also known as 12b-1 fees.[30]

Sales loads often are waived for mutual funds purchased through 401(k) plans, but 401(k) investors do incur the fund expenses of the mutual funds in their 401(k) accounts. Ongoing expenses are paid from fund assets, so investors pay these expenses indirectly. The total expense ratio, which reflects both the operating expense ratio—including portfolio management, fund administration and compliance, shareholder services, and other miscellaneous costs—and 12b-1 fees, is measured in this report as an asset-weighted average. Using the asset-weighted average to measure costs provides an aggregate estimate of what 401(k) participants actually pay to invest in mutual funds through their 401(k) plans. Under this approach, funds with larger shares of 401(k) mutual fund assets contribute proportionately more to the summary measure than do less widely held funds.

Understanding Fund and Share Class Categories

Many mutual funds offer several different share classes, all of which invest in the same portfolio (fund) while offering different services tailored to the needs of different investors or, in the case of 401(k) plans, the group of participants in the plan. The combination of sales loads and 12b-1 fees that an individual investor might pay will differ depending on the share class.

The Investment Company Institute categorizes funds or fund share classes as either *load funds* or *no-load funds*.

Load funds have a commission or sales load associated with them. Load funds can be further classified as either *front-end load, back-end load, level-load,* or *other load*. Front-end load funds carry an up-front sales charge and may have a 12b-1 fee, typically between 0.25 percent and 0.35 percent. Back-end load funds and other load funds are offered for sale at net asset value without a front-end load, but use combinations of 12b-1 fees and CDSLs. Level-load funds typically have an annual 12b-1 fee of 1.0 percent to compensate financial professionals for assisting investors. "Other" load funds are primarily designed for the retirement plan market.

The figures on load funds in this paper include load funds that waive sales loads for retirement plan investors (see Figure 6; and Figures A2 and A3 in the appendix).

No-load funds have no sales loads and have 12b-1 fees of 0.25 percent or less. The no-load funds are further classified as either (1) *institutional* or (2) *retail or general purpose*.

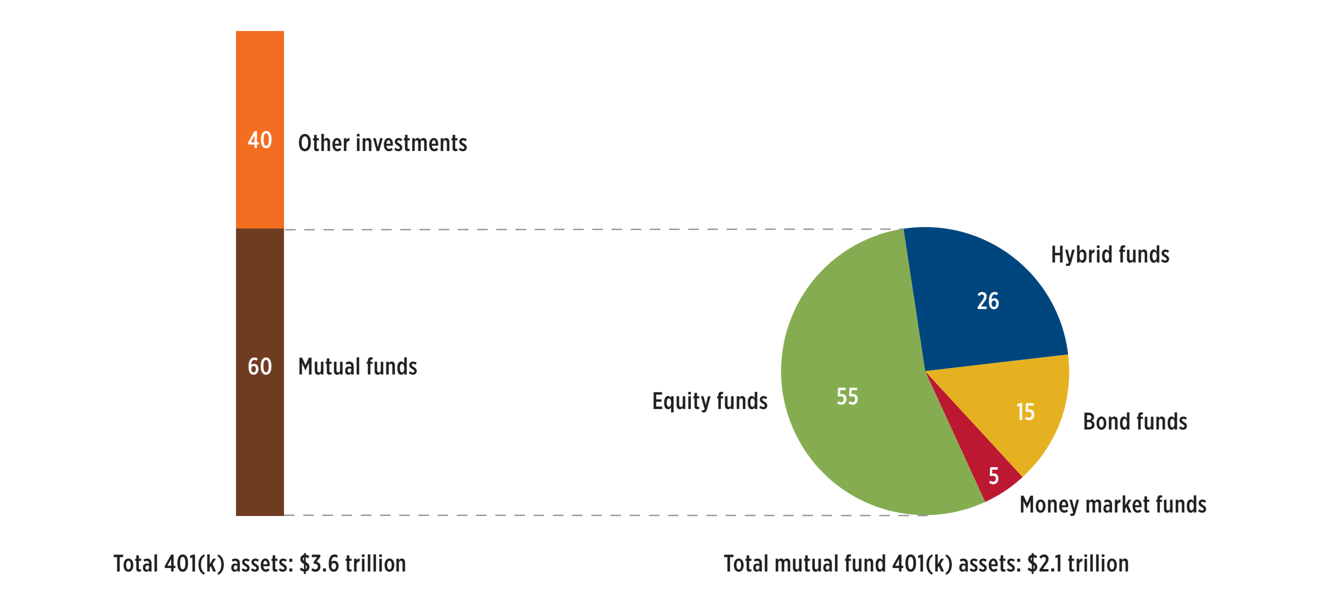
The figures in this paper classify a no-load fund as institutional if the fund's prospectus states that the fund or share class is designed to be sold primarily to institutional investors or institutional accounts. This includes investments by individuals in 401(k) accounts that are purchased by or through an institution such as an employer, trustee, or fiduciary on behalf of its employees, owners, or clients. The figures label the remaining no-load funds as retail or general purpose.

Similar designations have long been used in common parlance in the mutual fund industry. To some extent, however, their original connotations have become less meaningful as the industry has evolved, including those designations applied to 401(k) plans. Participant-directed 401(k) plans have characteristics associated with both "retail" investors (because each plan often has many individual accounts that must be maintained and investors that must be served) and "institutional" investors (in cases when the plan brings larger total investments). Nevertheless, these definitions are useful for certain research purposes such as illustrating trends in 401(k) plan assets held in mutual funds—for example, highlighting the fact that 401(k) plans may purchase shares through a range of funds and share classes.

FIGURE 4

More Than Half of 401(k) Plan Assets Were Invested in Mutual Funds

Percentage of assets, 2012



Note: Percentages may not add to 100 percent because of rounding.

Sources: Investment Company Institute, Federal Reserve Board, and U.S. Department of Labor

Trends in Funds and Share Classes Used in 401(k) Plans

No-load funds. At year-end 2012, no-load institutional funds were the most common funds (Figure 5).[31] This class has expanded as a share of 401(k) mutual fund assets over the past several years, growing from 17 percent of 401(k) mutual fund assets in 1996 to 54 percent at year-end 2012. The second-largest fund type was no-load retail or general purpose shares, which accounted for 30 percent of 401(k) mutual fund assets at year-end 2012. Altogether, 84 percent of 401(k) plan mutual fund assets were invested in no-load funds at year-end 2012.

Load funds. In 2012, the remaining 15 percent of mutual fund 401(k) assets were invested in load funds. Nine percent of 401(k) mutual fund investments were held through front-end load shares at year-end 2012 (Figure 5). Most funds waive front-end loads for retirement plans, so 401(k) plan participants generally are not charged a front-end load on shares purchased through their plans.[32] Most of the remaining 6 percent of mutual fund 401(k) assets were invested in share classes specifically designed for retirement plans, often referred to as "R shares." Level-load[33] and back-end load[34] shares represented a very small percentage of 401(k) mutual fund assets.[35]

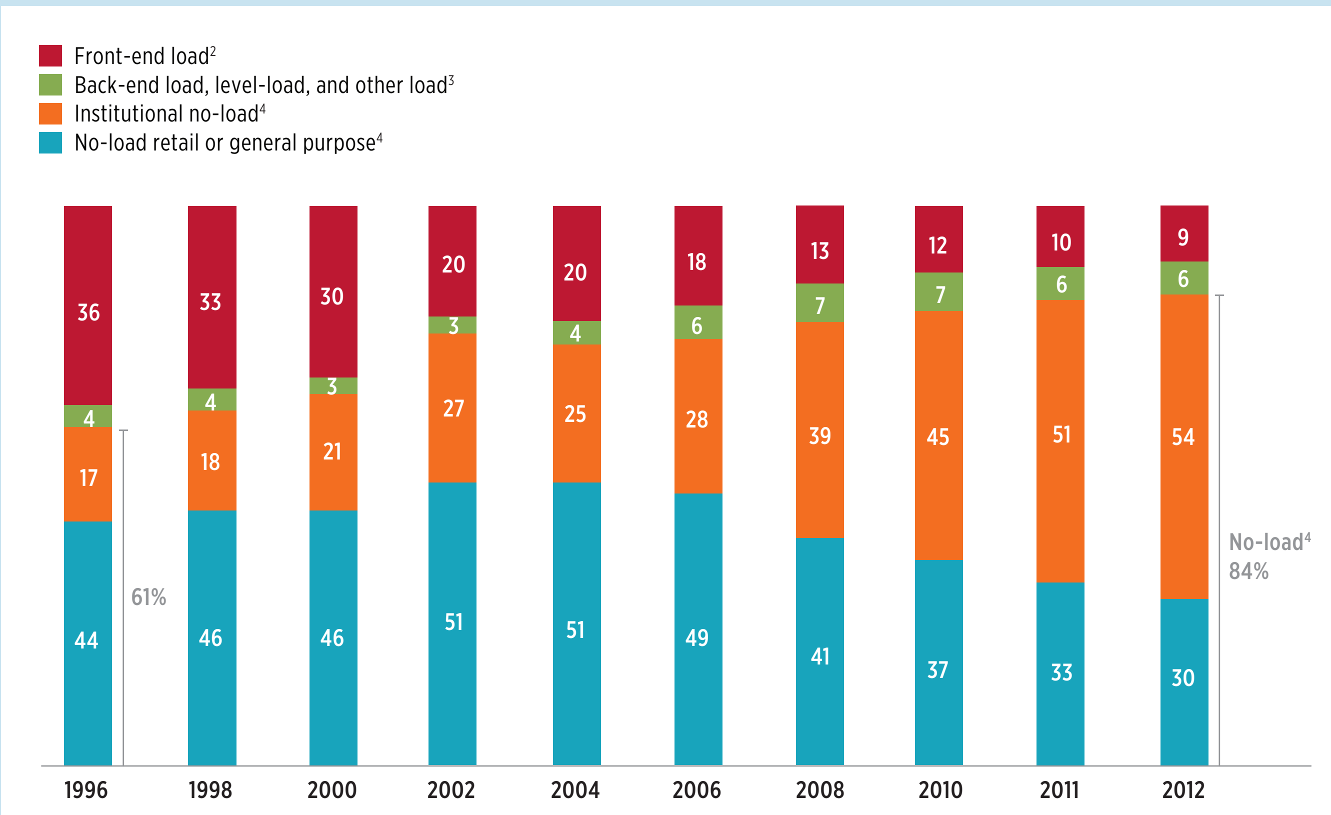
401(k) Participants Hold Lower-Cost Mutual Funds

Equity funds. Fifty-five percent of 401(k) plan assets invested in mutual funds were invested in equity funds at year-end 2012 (Figure 4).[36] Average equity fund expense ratios incurred by 401(k) investors declined in 2012,[37] consistent with the general industry trend. The asset-weighted average expenses paid by 401(k) investors on their equity funds fell to 0.63 percent in 2012, after having declined in four of the previous five years (Figure 6). In 2012, 401(k) investors continued to concentrate their equity fund assets in lower-cost funds. The average total expense ratio incurred by 401(k) investors in equity funds (0.63 percent) was less than half of the 1.40 percent simple average for all equity funds, and lower than the industrywide asset-weighted average of 0.77 percent. 401(k) mutual fund investors not only incur lower average expense ratios in equity funds overall, but also in each broad type of equity fund: domestic and foreign equity funds (Figure 7).

FIGURE 5

401(k) Mutual Fund Assets by Share Class

Percentage of assets,[1] selected years



[1] Percentages may not add to 100 percent because of rounding.

[2] Front-end load > 1 percent. Primarily includes A shares; includes assets where front-end loads are waived.

[3] See Figure A2 in the appendix for additional detail.

[4] No-load shares have front-end load = 0 percent, CDSL = 0 percent, and 12b-1 fee ≤ 0.25 percent.

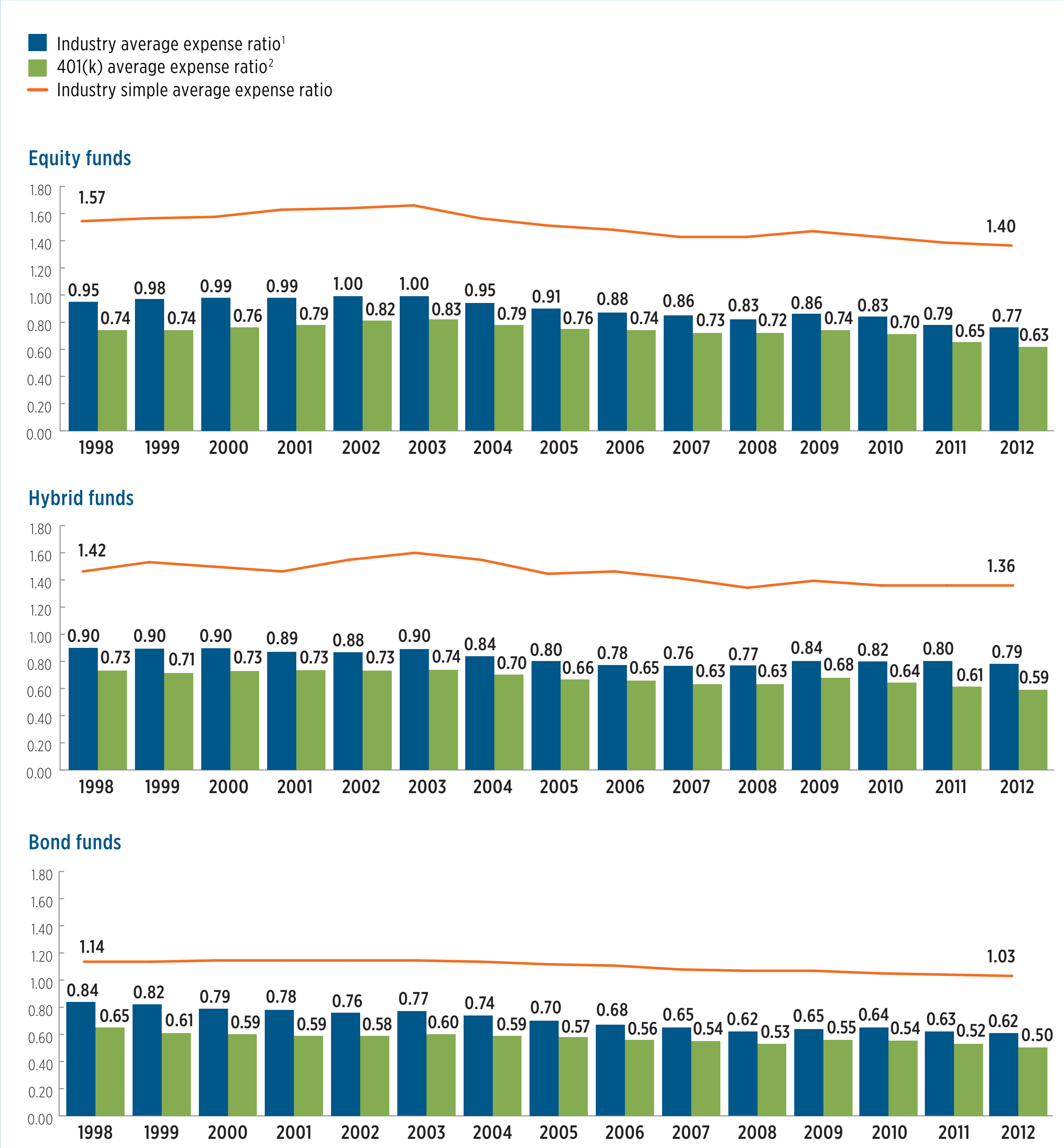
Note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds.

Sources: Investment Company Institute and Lipper

FIGURE 6

401(k) Mutual Fund Investors Tend to Pay Lower-Than-Average Expenses

Percent, 1998–2012



[1] The industry average expense ratio is measured as an asset-weighted average.

[2] The 401(k) average expense ratio is measured as a 401(k) asset-weighted average.

Note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds.

Sources: Investment Company Institute and Lipper

Several factors contribute to the relatively low average expense ratios incurred by 401(k) plan participants investing in mutual funds. Both inside and outside the 401(k) plan market, mutual funds compete among themselves and with other financial products to offer shareholders service and performance.[38] In addition, shareholders are sensitive to the fees and expenses that funds charge.[39] Indeed, new sales and assets tend to be concentrated in lower-cost funds, providing a market incentive for funds to offer their services at competitive prices.[40] In the 401(k) plan market, performance- and cost-conscious plan sponsors also impose market discipline. Plan sponsors regularly evaluate the performance of the plans' investments,[41] and performance reflects fees. In 2012, 47 percent of plan sponsors indicated that they had replaced a fund in the last year because of poor performance.[42]

The lower average expense ratios incurred by 401(k) participants also reflect other factors. Some plan sponsors choose to cover a portion of 401(k) plan costs, which allows them to select funds or share classes with less built-in servicing costs. Furthermore, many 401(k) plans have large average account balances, and such economies of scale help to reduce the fees and expenses of the funds offered in these plans.[43] Finally, unlike shareholders outside of 401(k) plans who typically pay for the assistance of a financial adviser when investing in mutual funds,[44] there is a more limited role for financial adviser services inside these plans.

Expense ratios vary among the mutual funds that 401(k) participants hold and 84 percent of 401(k) plan equity fund assets were invested in mutual funds with expense ratios less than 1.00 percent at year-end 2012 (Figure 8). Indeed, 35 percent of 401(k) equity fund assets were in mutual funds with expense ratios less than 0.50 percent.[45]

Hybrid funds. Twenty-six percent of 401(k) mutual fund assets were invested in hybrid funds, which invest in a mix of equities and bonds, at year-end 2012 (Figure 4). At year-end 2012, 401(k) hybrid fund investors paid an asset-weighted average expense ratio of 0.59 percent, less than half the industrywide simple average (1.36 percent) and 25 percent less than the industrywide asset-weighted average of 0.79 basis points (Figure 6).

FIGURE 7

Asset-Weighted Average Total Mutual Fund Expense Ratios

Percent, 2010–2012

	2010		2011		2012	
	Industry[1]	401(k)[2]	Industry[1]	401(k)[2]	Industry[1]	401(k)[2]
Equity funds	**0.83**	**0.70**	**0.79**	**0.65**	**0.77**	**0.63**
Domestic equity	0.77	0.65	0.73	0.61	0.71	0.59
Foreign equity	0.99	0.86	0.94	0.80	0.93	0.78
Hybrid funds	**0.82**	**0.64**	**0.80**	**0.61**	**0.79**	**0.59**
Bond funds	**0.64**	**0.54**	**0.63**	**0.52**	**0.62**	**0.50**
High yield and world bond	0.88	0.86	0.85	0.83	0.84	0.82
Other bond	0.58	0.51	0.57	0.50	0.56	0.47
Money market funds	**0.23**	**0.27**	**0.20**	**0.22**	**0.17**	**0.20**

[1] The industry average expense ratio is measured as an asset-weighted average.

[2] The 401(k) average expense ratio is measured as a 401(k) asset-weighted average.

Note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds.

Sources: Investment Company Institute and Lipper

Bond funds. Fifteen percent of 401(k) mutual fund assets were invested in bond funds at year-end 2012 (Figure 4). The asset-weighted average expense ratio paid by 401(k) investors on their bond funds fell slightly in 2012 (Figure 6). As was the case with equity funds, 401(k) bond fund investors have concentrated their assets in lower-cost bond funds. At year-end 2012, 401(k) bond fund investors paid an asset-weighted average expense ratio of 0.50 percent, about half the industrywide simple average (1.03 percent) and 19 percent less than the industrywide asset-weighted average of 0.62 percent. As with equity funds, the average expense ratio paid by 401(k) investors in bond funds is also lower in each of the broad subgroupings within bond funds (Figure 7).[46]

Money market funds. Only 5 percent of 401(k) mutual fund assets were invested in money market funds at year-end 2012 (Figure 4). For 401(k) participants holding money market funds, their total expense ratio was 0.20 percent in 2012, down from 0.22 percent in 2011 (Figure 7). The decline in money market fund fees over the past two years has been due in large part to individual funds reducing their fees (in many cases, as investment advisers waived advisory fees in the low interest rate environment).[47]

As noted earlier, in addition to the impact of the range and quality of services provided, a variety of factors affect the all-in fees of 401(k) plans. Furthermore, as with any other employee benefit, the costs associated with 401(k) plans are typically shared between the employer and plan participants.

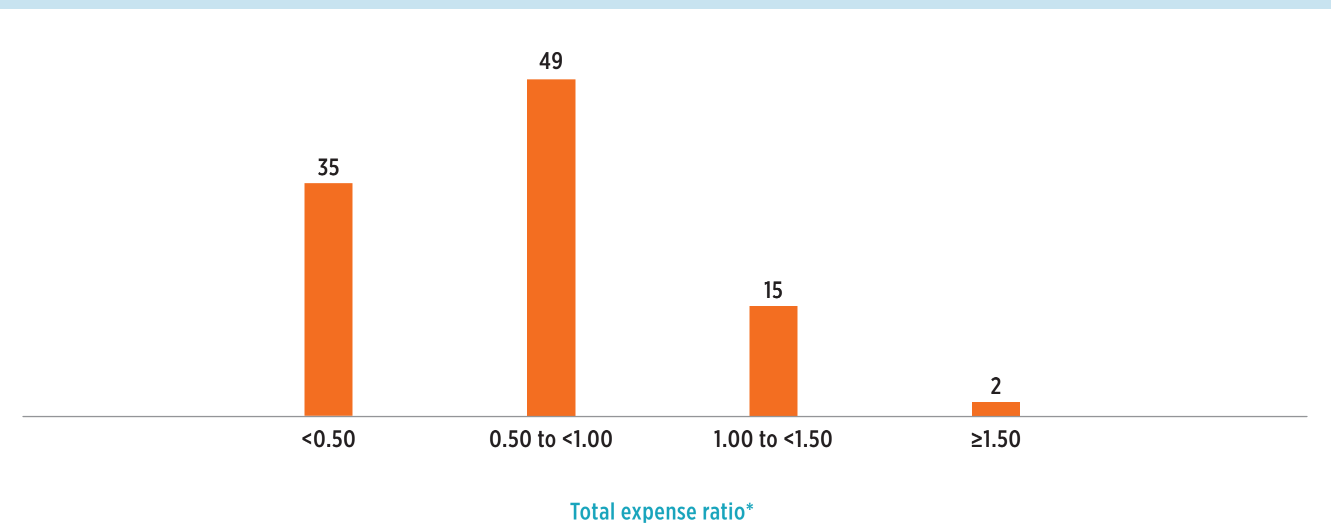
Participants who work for employers that do not heavily subsidize their plans will incur higher fees on average. Plans that charge account-level fees will tend to have lower-cost investment options than plans without direct account-level charges. Participants in plans with a small amount of assets will tend to pay higher fees per dollar invested than plans with greater assets because of the relatively fixed costs that all plans must incur. Participants in plans that have many small accounts will typically pay higher fees per dollar invested than plans with larger accounts. Plans with more service features will tend to be more costly than plans with fewer services for plan participants.

All of these factors influence the costs of the plan and the plan's investment options, and must be considered when evaluating the reasonableness of a given plan's costs.

FIGURE 8

401(k) Equity Mutual Fund Assets Are Concentrated in Lower-Cost Funds

Percentage of 401(k) equity mutual fund assets, 2012



*The total expense ratio, which is reported as a percentage of fund assets, includes fund operating expenses and the 12b-1 fee.

Note: Figures exclude mutual funds available as investment choices in variable annuities. Components do not add to 100 percent because of rounding.

Sources: Investment Company Institute and Lipper

Other Costs Incurred by Mutual Fund Investors

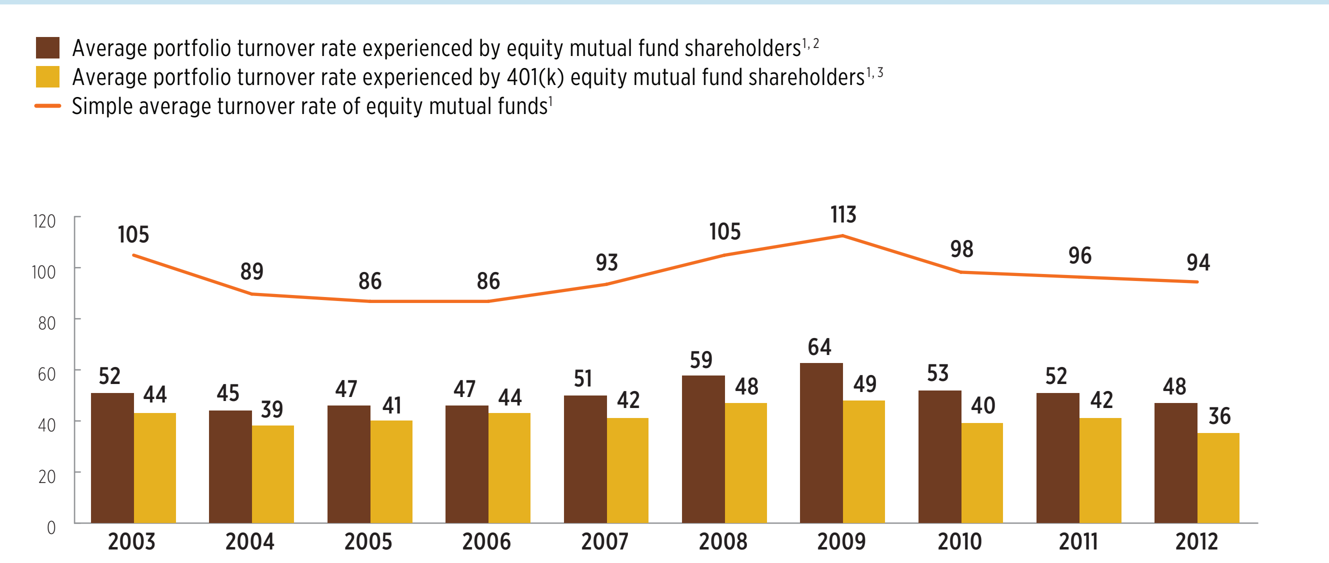
Another cost that mutual funds incur is the cost associated with buying and selling securities in the fund's portfolio. While these costs are not included in the fund's total expense ratio, they are reflected in the calculation of net return to the investor. To help shareholders evaluate the trading activity of a mutual fund, the Securities and Exchange Commission (SEC) requires each mutual fund to report its "turnover rate" in its annual shareholder report and in its prospectus.[48] Broadly speaking, the turnover rate is a measure of how rapidly a fund is trading the securities in its portfolio relative to total fund assets.[49] All pooled investments incur trading costs while managing their portfolios.

Equity fund turnover rates. Participants in 401(k) plans tend to own equity funds with lower-than-average turnover rates. The industrywide simple average turnover rate in equity funds was 94 percent in 2012 (Figure 9).[50] However, mutual fund shareholders tend to invest in equity funds with considerably lower turnover rates, as reflected in the lower industrywide asset-weighted average turnover rate of 48 percent. The average turnover rate experienced in equity funds selected by 401(k) plan participants is lower still: 36 percent in 2012 on an asset-weighted basis.

FIGURE 9

Average Portfolio Turnover Rate of Equity Funds

Percentage of assets, 2003–2012



[1] The turnover rate for each fund is calculated by dividing the lesser of purchases or sales of portfolio securities for the reporting period by the monthly average value of the portfolio securities owned by the fund during the reporting period.

[2] Average portfolio turnover rate experienced by equity mutual fund shareholders is measured as an asset-weighted average annual turnover rate based on the assets held in each fund (reported as a percentage of fund assets).

[3] Average portfolio turnover rate experienced by 401(k) equity mutual fund shareholders is measured as an asset-weighted average annual turnover rate based on 401(k) plan assets held in each fund (reported as a percentage of 401(k) fund assets).

Note: Figures exclude mutual funds available as investment choices in variable annuities.

Sources: Investment Company Institute and Strategic Insight Simfund

Conclusion

401(k) plans are now the most common private-sector employer-sponsored retirement plan in the United States. Employers choose whether to offer these plans to employees as part of their total compensation packages; employees choose whether to participate. The creation and maintenance of a 401(k) plan involve a variety of services, and the costs of these services are generally shared by the plan sponsor and the plan participants.

401(k) plans provide many American workers with the opportunity for cost-effective investment in mutual funds. 401(k) plan participants primarily invest in equity funds, and the bulk of these equity fund assets is held in lower-cost mutual funds with lower-than-average portfolio turnover.

Numerous factors contribute to the relatively low expense ratios incurred by 401(k) plan participants investing in mutual funds. Among them are: (1) competition among mutual funds and other investment products to offer shareholders service and performance; (2) plan sponsors' decisions to cover a portion of the 401(k) plan costs, which allow them to select lower-cost funds or share classes; (3) economies of scale that a large investor such as a 401(k) plan can achieve; (4) cost- and performance-conscious decisionmaking by plan sponsors and plan participants; and (5) the limited role of professional financial advisers in these plans.

Additional Reading

- **"Trends in the Expenses and Fees of Mutual Funds, 2012."** *ICI Research Perspective.* Available at www.ici.org/pdf/per19-03.pdf.
- ***Inside the Structure of Defined Contribution/401(k) Plan Fees.*** Deloitte Consulting LLP and Investment Company Institute. Available at www.ici.org/pdf/rpt_11_dc_401k_fee_study.pdf.
- **"The U.S. Retirement Market, Fourth Quarter 2012."** Investment Company Institute. Available at www.ici.org/info/ret_12_q4_data.xls.
- **ICI Resources on 401(k) Plans.** Investment Company Institute. Available at www.ici.org/401k.
- **ICI Resources on 12b-1 Fees.** Investment Company Institute. Available at www.ici.org/rule12b1fees.

Notes

[1] See Investment Company Institute 2013a.

[2] Section 401(k) of the IRC was added by Congress in 1978, to be effective beginning in 1980 (see Revenue Act of 1978, P.L. 95-600). However, companies generally did not begin to adopt 401(k) plans until the Department of the Treasury and the IRS issued proposed regulations clarifying the scope of Section 401(k) on November 10, 1981 (see 46 Fed. Reg. 55544, November 10, 1981; Holden, Brady, and Hadley 2006).

[3] The main advantages of a tax-qualified 401(k) plan are that employers are able to take an immediate deduction for contributions made by the employer, employees are able to defer taxation of contributions, and employees do not pay income tax on contributions or earnings until the monies are distributed. (For a detailed explanation of the tax benefits of deferral, see Brady 2012.) In exchange for this special tax treatment, the IRC imposes numerous conditions, many of which are designed to ensure that participants in all income ranges attain the benefits of the plan. For additional discussion, see, for example, Allen et al. 1997. Since 2006, employers can offer a Roth 401(k) option, which, like Roth IRAs, allows employees to contribute on an after-tax basis but receive distributions tax free. Like Roth IRAs, earnings are subject to income tax if the employee distributes them within five years of first contributing to the Roth 401(k) or before reaching age 59½.

[4] ERISA requires that the plan sponsor appoint a "named" fiduciary or fiduciaries to administer the plan. See ERISA Section 402. A plan sponsor may, and often does, name itself as the plan administrator. In its role as the plan administrator, the employer assumes fiduciary responsibility to select and monitor service providers and investment options for the plan. Most employers appoint a retirement committee consisting of senior human resource or other employees to oversee the administration of the plan. In their role acting for the employer as plan administrator, the members of the committee assume fiduciary responsibility to administer the plan solely in the interest of plan participants and beneficiaries. For convenience, this report often refers to "employer" and "plan sponsor" to mean the fiduciary or fiduciaries appointed to administer the plan.

[5] Department of Labor Reg. Section 2550.404c-1.

[6] Plan Sponsor Council of America 2012 indicated that 95.8 percent of the 840 profit-sharing and 401(k) plans surveyed offer participants the ability to initiate daily fund transfers.

[7] To protect the 401(k) plan's assets, ERISA Section 403 requires that pension plan assets be held in a trust or invested in insurance contracts.

[8] Plan Sponsor Council of America 2012 reported the array of educational resources used by plan sponsors, which includes enrollment kits, newsletters, fund performance sheets, intranet sites, webinars, seminars, workshops, paycheck stuffers, retirement gap calculators, posters, and individually targeted communication. The most commonly cited primary purpose for plan education is increasing participation (81.4 percent of plans).

[9] Where participants are given the control of the investment of their accounts, which is common in 401(k) plans, the selection of the investment options available is usually designed to meet the requirements of Section 404(c) of ERISA. This section provides liability relief for plan sponsors and other plan fiduciaries from losses in plan accounts resulting from employees' exercise of investment control. The DOL regulations under ERISA Section 404(c) are designed to ensure that participants have control over their assets and have adequate opportunity to diversify their holdings. Plans must offer at least three diversified investment options with materially different risk and return characteristics. (Although company stock or any individual stock can be offered in 401(k) plans, they would not qualify as one of the three core options.) Plans generally must allow transfers among the diversified investment options at least quarterly. Hewitt Associates 2007 indicated that 90 percent of the 292 plans surveyed in the spring of 2007 considered themselves compliant with ERISA Section 404(c). Aon Hewitt 2012 indicated an average number of investment options of 20 in 2011; Plan Sponsor Council of America 2012 indicated that the average number of investment fund options available for participant contributions was 19 in 2011. Deloitte Consulting LLP, the International Foundation of Employee Benefit Plans, and the International Society of Certified Employee Benefit Specialists 2012 reported that the average number of funds offered by the responding 401(k) plan sponsors in their survey was 19 in 2012, compared with 18 in early 2011.

[10] The IRC includes a number of flat annual dollar contribution limits. In addition, several sections of the IRC provide a framework for nondiscrimination testing, which limits contributions to 401(k) plans to ensure that employees in all income ranges benefit from the plan. For example, the actual deferral percentage (ADP) nondiscrimination test essentially requires that the before-tax contributions of highly compensated employees (as a percentage of their eligible compensation) do not exceed the contributions of non–highly compensated employees (as a percentage of their eligible compensation) by more than a specified amount.

[11] Plans file their annual reports on Form 5500, which is a joint form of the DOL, the IRS, and the Pension Benefit Guaranty Corporation (PBGC). The DOL publishes summary annual reports tabulating the Form 5500 data (see U.S. Department of Labor, Employee Benefits Security Administration).

[12] For example, plans may incur costs responding to requests for information pursuant to SEC Rule 22c-2, under which mutual funds may obtain trading information necessary to ensure compliance with the fund's short-term trading policies. In addition, 401(k) plans that allow participants to invest in the employer's stock must register with the SEC on Form S-8. ERISA preempts most state laws that relate to employee benefit plans, but plans may still need to comply with state tax laws relating to withholding and information filing. The Bureau of Consumer Financial Protection created by the Wall Street Reform and Consumer Protection Act of 2010 potentially has the ability to regulate service providers to 401(k) plans, but only with respect to specific regulatory areas approved by the DOL and the Department of the Treasury.

[13] For discussion of regulations governing mutual funds, see Investment Company Institute 2013b.

[14] See U.S. Treasury Department and U.S. Department of Labor, "Understanding Retirement Plan Fees and Expenses." See also U.S. Department of Labor, Employee Benefits Security Administration, "Selecting and Monitoring Pension Consultants—Tips for Plan Fiduciaries" and "Tips for Selecting and Monitoring Service Providers for Your Employee Benefit Plan." Some commentators, however, have argued that the core standard under ERISA that governs plan fiduciaries—the duty of prudence—requires that fiduciaries engage in a prudent process in evaluating a plan's investments and services and does not require a particular result. See Vine 2010.

[15] See 77 Fed. Reg. 5632 (February 3, 2012).

[16] See U.S. Treasury Department and U.S. Department of Labor, "U.S. Treasury, Labor Departments Act to Enhance Retirement Security for an America Built to Last."

[17] See U.S. Department of Labor, Employee Benefits Security Administration, "Understanding Retirement Plan Fees and Expenses" and "A Look at 401(k) Plan Fees." See also U.S. Securities and Exchange Commission, "Calculating Mutual Fund Fees and Expenses" and "Mutual Fund Fees and Expenses."

[18] See 75 Fed. Reg. 64910 (October 20, 2010). Under the regulation, participants must receive general plan information and investment-related information before making an initial investment decision, and annually thereafter. This includes how to give investment instructions and what, if any, account fees or fees for individual services (e.g., loans, investment advice) participants pay. The regulation requires that participants be given a comparative chart showing for each investment in the plan's investment lineup: the name and type of investment; sales charges and any restrictions on withdrawal; the expense ratio; the annual dollar cost of the expense ratio for each $1,000 invested (assuming no returns); the 1-, 5-, and 10-year performance; and the performance of a benchmark index over the same period. Participants are referred to a website for more information on the investment's objectives, principal strategies and risks, portfolio turnover rate, and quarterly updated performance data. Although there are some differences, the information required is similar to the information that mutual fund investors receive as part of a fund's prospectus. The initial disclosures under this regulation were due, in most cases, 60 days after the July 1, 2012, effective date for the service provider disclosure regulation, or August 30, 2012. The DOL provides information to help employees learn about fees associated with their 401(k) plans. See U.S. Department of Labor, Employee Benefits Security Administration, "A Look at 401(k) Plan Fees." The SEC also provides investor education at www.sec.gov/investor.shtml.

[19] Plan sponsors use a variety of arrangements to obtain services for their 401(k) plans. When multiple service providers are used, it is an "unbundled" arrangement, and the expenses of each provider (e.g., trustee, recordkeeper, communications firm, investment manager) are charged separately to the plan. Alternatively, the plan sponsor can select one provider that provides a number of services (sometimes referred to as a "bundled" arrangement). The single provider interacts with the plan and then pays for the other bundled services out of the fees it collects from the plan. Some plans use a combination of these approaches, such as selecting a single provider for administrative participant services and one or more providers for investment options. In this case, costs of administering the plan may be defrayed out of fees paid by the investment product, which are reflected in the fund's expense ratio, rather than through a direct charge paid by plan participants of the plan sponsor. In the case of mutual funds, fees can be netted from fund assets to compensate the service provider for the services it provides to the fund. The new DOL regulations described in note 15 require service providers that provide recordkeeping as part of a bundle to give the plan a reasonable and good faith estimate of the cost to the plan of the recordkeeping services.

[20] U.S. Department of Labor Opinion Letters 97-03A (January 23, 1997) and 2001-01A (January 18, 2001).

[21] For the most part, 401(k) plan assets are held in individual accounts established for each participant. However, the costs of running a 401(k) plan also may be partly defrayed through employee "forfeitures." Employees who terminate employment without fully vesting (that is, earning full ownership of account assets) forfeit matching or other employer contributions (participants are always 100 percent vested in their own contributions). These forfeitures are typically used to offset fees or pay for additional employer contributions. Deloitte Consulting LLP, the International Foundation of Employee Benefit Plans, and the International Society of Certified Employee Benefit Specialists 2012 reported that 64 percent of plans that had matching contributions used those matching contribution forfeitures to reduce employer contributions; 35 percent used these funds to offset fees; 9 percent

reallocated the forfeitures to participants; and 12 percent did something else ("other"). (Plans can indicate more than one use of these funds.) Plan Sponsor Council of America 2012 reported that 66.6 percent of 401(k) plans allocate forfeitures to reduce company contributions; 12.2 percent of 401(k) plans allocate the forfeitures among participants (based on account balances, 5.1 percent; based on participant contributions, 2.0 percent; or based on participant's share of company contributions, 5.1 percent); 37.5 percent of plans applied forfeitures to reduce plan expenses; and 1.7 percent of plans did something else ("other"). The IRC and ERISA determine the maximum vesting schedule for 401(k) plans and require that employer contributions made to the 401(k) plan not be removed from the plan. In addition, plans may charge fees for certain transactions, such as taking a loan or making a withdrawal, and participants typically pay those fees in full when engaging in the specific activity.

[22] See Deloitte Consulting LLP and Investment Company Institute 2011 for full results and regression analysis of the fee data from the survey.

[23] GICs are insurance company products that promise a specific rate of return on invested capital over the life of a contract. A similar investment option is a synthetic GIC, which consists of a portfolio of fixed-income securities "wrapped " with a guarantee (typically by an insurance company or bank) to provide benefit payments according to the terms of the plan. For additional discussion of these investment options and 401(k) plan participants' asset allocations, see Holden et al. 2012.

[24] Company stock is the stock of the plan sponsor (employer). See Holden et al. 2012 for additional discussion of 401(k) participant investment in company stock in 401(k) plans.

[25] Plan Sponsor Council of America 2012 indicated that 21.7 percent of 401(k) plans offer a self-directed brokerage window and 5.4 percent of plans offer a self-directed mutual fund window.

[26] For additional information on mutual funds and the U.S. retirement market, see Investment Company Institute 2013a.

[27] See Reid and Rea 2003; Investment Company Institute 2004, 2005, and 2013b; and Gallagher 2013.

[28] See Investment Company Institute 2013a.

[29] Additional servicing fees not reflected in the mutual fund total expense ratios are not captured in this analysis, nor is the cost of holding other types of investments in 401(k) plans.

[30] Financial advisers, retirement plan recordkeepers, discount brokerages, and other financial intermediaries provide an array of important and valuable services to mutual fund shareholders. In the context of 401(k) plans, these services can include recordkeeping, transaction processing, participant communication, education and advice, and regulatory and compliance services (see Figure 2). Mutual funds and their investment advisers use a variety of arrangements to compensate plan service providers for these services. Under one arrangement, a mutual fund's board of directors may adopt a plan pursuant to Rule 12b-1 under the Investment Company Act of 1940. As explained in U.S. Securities and Exchange Commission, "Mutual Fund Fees and Expenses," Rule 12b-1 allows mutual funds to use fund assets to cover distribution expenses and shareholder service expenses. "Distribution" fees include fees paid for marketing and selling fund shares, such as compensating brokers and others who sell fund shares as well as paying for advertising, the printing and mailing of prospectuses to new investors, and the printing and mailing of sales literature. Under Financial Industry Regulatory Authority (FINRA, formerly the National Association of Securities Dealers [NASD]) rules, 12b-1 fees that are used to pay marketing and distribution expenses (as opposed to shareholder services) cannot exceed 75 basis points (NASD Conduct Rule 2830(d)). "Shareholder service" fees are fees paid to respond to investor inquiries and provide investors with information about their investments. A mutual fund may pay shareholder service fees without adopting a 12b-1 plan. FINRA imposes an annual 25 basis point cap on shareholder service fees (regardless of whether these fees are authorized as part of a 12b-1 plan). For further discussion of 12b-1 fees and how funds use them, see Investment Company Institute 2005 and "ICI Resources on 12b-1 Fees," available at www.ici.org/rule12b1fees.

At year-end 2012, 78 percent of equity mutual fund assets held in 401(k) plans were invested in funds that had no 12b-1 fee; another 14 percent of 401(k) plan equity mutual fund assets were invested in funds with 12b-1 fees of 25 basis points or less (see Figure A6 in the appendix).

Funds also may pay service providers for sub-transfer agency services or administrative services out of fund assets (this is reflected in the fund's total expense ratio in the "other expense" category). The fund's adviser (or a related entity) also may compensate the service provider(s) out of the profits earned from the advisory fee collected from the fund.

[31] See Figure A2 in the appendix for additional detail and historical data. In addition, see Figure A3 in the appendix for mutual fund assets by share class by type of mutual fund (equity funds, hybrid funds, and bond funds).

[32] See Reid and Rea 2003.

[33] Level-load shares, which include Class C shares, typically have an annual 12b-1 fee of 100 basis points and a CDSL set at 1 percent in the first year the shares are held. After the first year, no CDSL is charged on redemptions. These shares usually do not convert to Class A shares. For additional details, see Investment Company Institute 2013b and Reid and Rea 2003.

[34] Back-end load shares, which are primarily Class B shares, typically have an annual 12b-1 fee of 100 basis points and a CDSL set at 5 percent in the first year the shares are held; then the CDSL falls in units of 1 percentage point per year, reaching 0 percent in the sixth or seventh year in which the shares are

held. Back-end load shares that are transferred or exchanged within a fund family are not subject to the CDSL. Generally, after six to eight years, Class B shares convert to Class A shares, which lowers the level of the 12b-1 fee from 100 basis points to that of Class A shares. For additional details, see Investment Company Institute 2013b and Reid and Rea 2003.

[35] See Figure A2 in the appendix for additional detail.

[36] Expense information is not available for mutual funds held as investment choices in variable annuities (often referred to as VA mutual funds).

[37] For additional discussion of industrywide mutual fund fee trends, see Gallagher 2013.

[38] For a more-detailed discussion of competition in the mutual fund industry, see Coates and Hubbard 2006, Stevens 2006, Reid 2006, and Investment Company Institute 2013b.

[39] In February 2006, ICI conducted an in-home survey of 737 randomly selected fund owners who had purchased shares of stock, bond, or hybrid mutual funds outside workplace retirement plans in the preceding five years (see Investment Company Institute 2006). On average, recent mutual fund investors considered nine distinct items of information about a fund before purchasing shares, five of which they considered "very important" to making the final decision to invest in a fund. Seventy-four percent of recent fund investors wanted to know about a fund's fees and expenses before purchasing shares; 69 percent reviewed or asked questions about the fund's historical performance.

[40] For example, see Investment Company Institute 2013b and Collins 2005.

[41] Deloitte Consulting LLP, the International Foundation of Employee Benefit Plans, and the International Society of Certified Employee Benefit Specialists 2012 reported that 69 percent of the plans they surveyed evaluated and benchmarked the performance of plan investments on a quarterly basis; 11 percent semiannually; 15 percent annually; and 5 percent at some other frequency.

[42] Deloitte Consulting LLP, the International Foundation of Employee Benefit Plans, and the International Society of Certified Employee Benefit Specialists 2012 found that 47 percent of plans had replaced a fund due to poor performance within the last year; 24 percent had replaced a fund one year to less than two years ago; 14 percent had replaced a fund two years to less than five years ago; 6 percent had last replaced a fund five or more years ago; and 9 percent had never replaced a fund.

[43] The size of the plan, in terms of assets and participants and the average account balance, are key factors in the pricing of services. As stated in the text, however, a variety of factors influence the total fees of a plan and all of these factors must be considered when evaluating the reasonableness of a given plan's cost. In addition, the reasonableness of fees paid by a particular plan is different from the question of whether a plan fiduciary engaged in a prudent process under ERISA in selecting and monitoring plan services and investments (see note 14).

[44] Investment Company Institute 2013b reported that among mutual fund shareholders owning funds outside of employer-sponsored retirement plans, 82 percent owned fund shares through investment professionals in 2012. Schrass 2013, which analyzed mutual fund–owning households' ongoing advisory relationships, found that DC account ownership decreased the probability of having an ongoing advisory relationship, while IRA ownership increased the probability of the mutual fund–owning household having an ongoing advisory relationship. In the regression analysis, these variables were highly significant and their interaction with ongoing advisory relationships makes intuitive sense: financial advice is more readily available outside of employer-sponsored retirement plans, and rollover activity, which is common throughout people's working lives, generates traditional IRAs, which are considered to be outside employer-sponsored plans. Financial advisers provide a range of services to investors: they generally help investors to identify financial goals and recommend funds to meet those goals, conduct transactions, maintain financial records, and coordinate the distribution of prospectuses, financial reports, and proxy statements (see Leonard-Chambers and Bogdan 2007).

[45] For the distribution of expense ratios of mutual funds held in 401(k) plans by more-detailed investment objectives, see Figure A4 in the appendix.

[46] For additional information, see Gallagher 2013.

[47] The average expense ratio of money market funds industrywide decreased in 2012 as a result of a general decline in expense ratios from waivers primarily due to the low interest rate environment, in addition to a shift in assets to lower-cost funds. See Gallagher 2013 for additional detail.

[48] The SEC has adopted modifications to its prospectus rules that make the turnover rate more prominent by moving the turnover rate to the summary section at the beginning of the prospectus. See 74 Fed. Reg. 4546 (January 26, 2009). The new DOL rules described in note 18 will require that participants have access to a website showing, among other information, the portfolio turnover rate for each investment in the plan's lineup.

[49] The SEC requires that the turnover rate be calculated by dividing the lesser of purchases or sales of portfolio securities for the reporting period by the monthly average of the value of the portfolio securities owned by the fund during the same reporting period.

[50] For a more-detailed discussion of portfolio turnover, see Reid and Millar 2004.

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Appendix

FIGURE A1

Who Pays Annual 401(k) Recordkeeping/Administrative Fees?

Percentage of plans surveyed,[1] 2012

	Percent
Plan sponsor	**18**
Participant	**67**
Via investment product fees and expenses[2]	51
Via additional reduction to investment returns[2]	5
Via direct charge	11
Pro rata based on account balances	3
Equal dollar to all participants	6
Other	2
Direct fees paid by both plan sponsor and participants	**8**
Other	**7**

[1] This figure reports tabulations based on the 294 401(k) plan sponsors that responded to this question. (The survey covers nearly 400 401(k) plan sponsors.)

[2] These are additional administrative or recordkeeping fees in the form of a wrap fee or added basis point charge.

Source: Investment Company Institute tabulation of data from Deloitte Consulting LLP, the International Foundation of Employee Benefit Plans, and the International Society of Certified Employee Benefit Specialists, *Annual 401(k) Benchmarking Survey* (2012)

FIGURE A2

401(k) Mutual Fund Assets by Share Class

Percentage of assets,[1] 1998–2012

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Load	**36**	**36**	**33**	**32**	**22**	**24**	**24**	**23**	**23**	**22**	**20**	**20**	**18**	**17**	**16**
Front-end load[2]	33	33	30	29	20	21	20	18	18	16	13	13	12	10	9
Back-end load[3]	3	2	2	2	1	1	1	1	1	(*)	(*)	(*)	(*)	(*)	(*)
Level load[4]	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Other load[5]	(*)	(*)	(*)	(*)	(*)	1	2	3	4	5	6	6	6	6	6
No-load[6]	**64**	**64**	**67**	**68**	**78**	**76**	**76**	**77**	**77**	**78**	**80**	**80**	**82**	**83**	**84**
Institutional	18	18	21	24	27	26	25	27	28	31	39	41	45	51	54
Retail or general purpose	46	46	46	44	51	50	51	50	49	47	41	39	37	33	30
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

[1] Components may not add to the total because of rounding.

[2] Front-end load > 1 percent. Primarily includes A shares; includes assets where front-end loads are waived.

[3] Front-end load = 0 percent, CDSL > 2 percent. Primarily includes B shares.

[4] Front-end load ≤ 1 percent, CDSL ≤ 2 percent, and 12b-1 fee > 0.25 percent. Primarily includes C shares; excludes institutional share classes.

[5] All other load share classes not classified as front-end load, back-end load, or level-load shares. Primarily includes retirement share classes known as R shares.

[6] Front-end load = 0 percent, CDSL = 0 percent, and 12b-1 fee ≤ 0.25 percent.

(*) = less than 0.5 percent

Note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds.

Sources: Investment Company Institute and Lipper

FIGURE A3

401(k) Mutual Fund Assets by Share Class

Percentage of assets,[1] selected years

Equity funds	1996	2006	2008	2010	2011	2012
Load	**48**	**25**	**24**	**20**	**18**	**17**
Front-end load[2]	45	20	16	13	11	10
Back-end load[3]	3	1	(*)	(*)	(*)	(*)
Level load[4]	1	1	1	1	1	1
Other load[5]	(*)	4	7	7	6	6
No-load[6]	**52**	**75**	**76**	**80**	**82**	**83**
Institutional	12	23	31	40	47	51
Retail or general purpose	40	52	45	40	35	33
Total	**100**	**100**	**100**	**100**	**100**	**100**
Hybrid funds	**1996**	**2006**	**2008**	**2010**	**2011**	**2012**
Load	**26**	**26**	**27**	**23**	**21**	**22**
Front-end load[2]	22	17	15	13	11	10
Back-end load[3]	4	1	1	(*)	(*)	(*)
Level load[4]	(*)	1	1	1	1	1
Other load[5]	(*)	7	10	8	8	10
No-load[6]	**74**	**74**	**73**	**77**	**79**	**78**
Institutional	7	13	19	31	36	37
Retail or general purpose	67	62	55	46	43	41
Total	**100**	**100**	**100**	**100**	**100**	**100**
Bond funds	**1996**	**2006**	**2008**	**2010**	**2011**	**2012**
Load	**29**	**17**	**15**	**15**	**16**	**15**
Front-end load[2]	22	13	11	11	10	10
Back-end load[3]	4	1	(*)	(*)	(*)	(*)
Level load[4]	1	1	1	(*)	(*)	(*)
Other load[5]	2	2	3	4	5	4
No-load[6]	**71**	**83**	**85**	**85**	**84**	**85**
Institutional	33	56	59	59	61	65
Retail or general purpose	38	27	26	26	23	21
Total	**100**	**100**	**100**	**100**	**100**	**100**

[1] Components may not add to the total because of rounding.

[2] Front-end load > 1 percent. Primarily includes A shares; includes assets where front-end loads are waived.

[3] Front-end load = 0 percent, CDSL > 2 percent. Primarily includes B shares.

[4] Front-end load ≤ 1 percent, CDSL ≤ 2 percent, and 12b-1 fee > 0.25 percent. Primarily includes C shares; excludes institutional share classes.

[5] All other load share classes not classified as front-end load, back-end load, or level-load shares. Primarily includes retirement share classes known as R shares.

[6] Front-end load = 0 percent, CDSL = 0 percent, and 12b-1 fee ≤ 0.25 percent.

(*) = less than 0.5 percent

Note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds.

Sources: Investment Company Institute and Lipper

FIGURE A4

401(k) Mutual Fund Assets by Investment Objective and Total Expense Ratio

Percentage of assets,[1] 2012

	Total expense ratio[2]			
	<0.50	0.50 to <1.00	1.00 to <1.50	≥1.50
Total	**45**	**42**	**11**	**2**
Equity funds	**35**	**49**	**15**	**2**
Domestic equity	39	47	13	1
Foreign equity	19	55	21	5
Hybrid	**40**	**49**	**9**	**2**
Bond funds	**61**	**34**	**4**	**1**
High yield and world bond	6	74	17	4
Other bond	66	31	3	(*)
Money market funds	**100**	**(*)**	**(*)**	**(*)**

[1] Row percentages may not add to 100 percent because of rounding.

[2] The total expense ratio, which is reported as a percentage of fund assets, includes fund operating expenses and the 12b-1 fee.

(*) = less than 0.5 percent

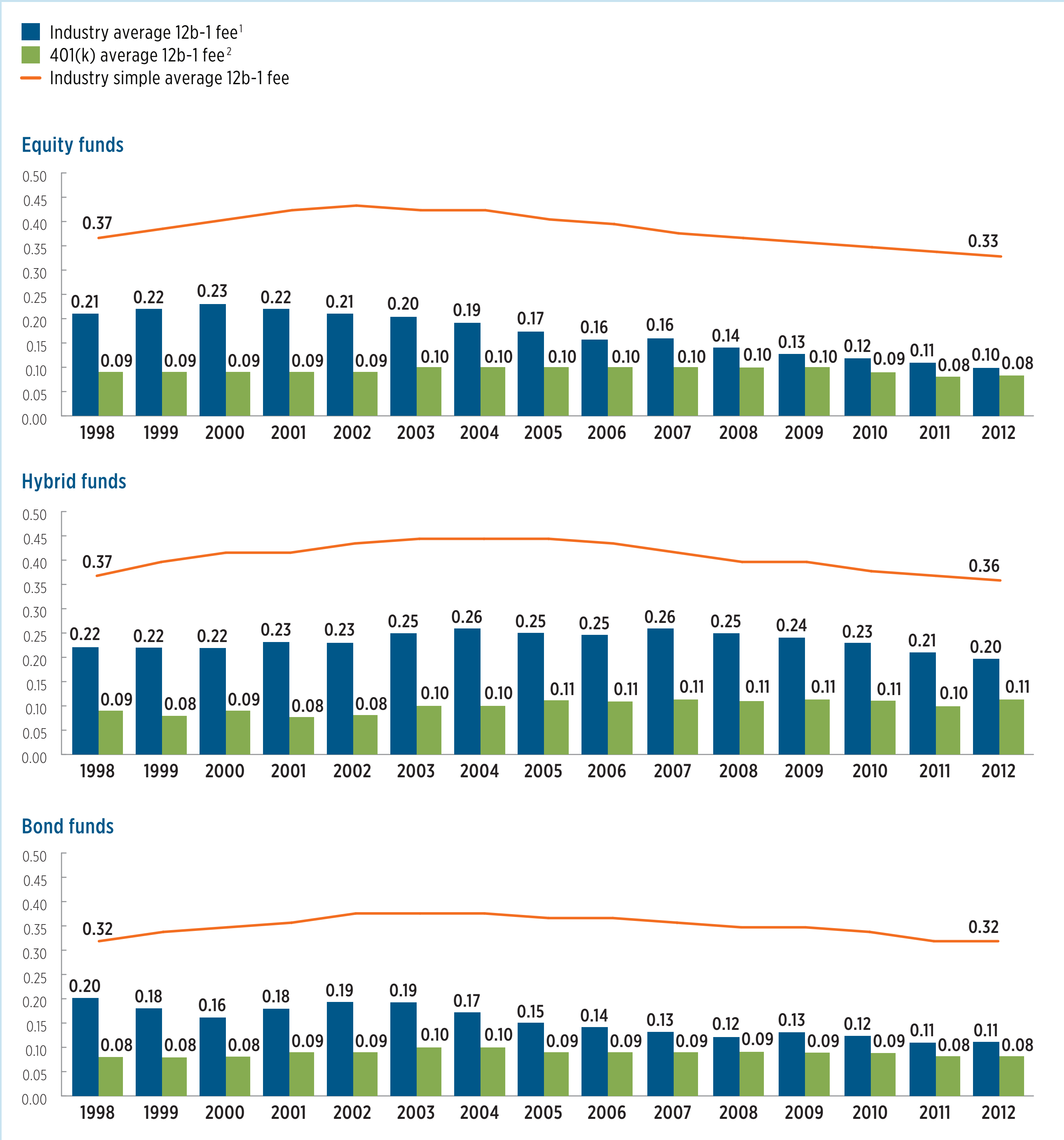
Note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds.

Sources: Investment Company Institute and Lipper

FIGURE A5

401(k) Mutual Fund Investors Tend to Pay Lower-Than-Average 12b-1 Fees

Percent, 1998–2012



[1] The industry average 12b-1 fee is measured as an asset-weighted average.

[2] The 401(k) average 12b-1 fee is measured as a 401(k) asset-weighted average.

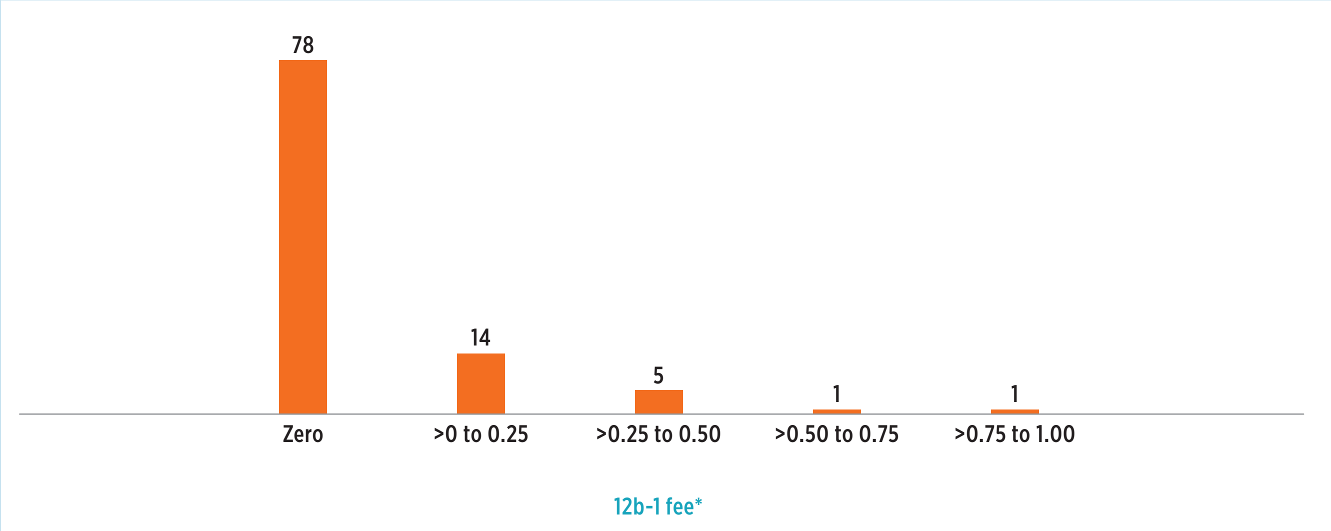
Note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds. Figures include mutual funds without 12b-1 fees.

Sources: Investment Company Institute and Lipper

FIGURE A6

401(k) Equity Mutual Fund Assets by 12b-1 Fee

Percentage of 401(k) equity mutual fund assets, 2012



*The 12b-1 fee is reported as a percentage of mutual fund assets.

Note: Figures exclude mutual funds available as investment choices in variable annuities. Components do not add to 100 percent because of rounding.

Sources: Investment Company Institute and Lipper

FIGURE A7

401(k) Mutual Fund Assets by Investment Objective and 12b-1 Fee

Percentage of assets, 2012

	12b-1 fee*				
	Zero	>0 to 0.25	>0.25 to 0.50	>0.50 to 0.75	>0.75 to 1.00
Total	**79**	**14**	**5**	**1**	**1**
Equity funds	**78**	**14**	**5**	**1**	**1**
Domestic equity	81	12	5	1	1
Foreign equity	69	20	8	2	1
Hybrid	**76**	**11**	**6**	**4**	**3**
Bond funds	**75**	**21**	**3**	**1**	**1**
High yield and world bond	60	28	8	2	2
Other bond	76	20	3	1	1
Money market funds	**96**	**3**	**(*)**	**(*)**	**(*)**

*The 12b-1 fee is reported as a percentage of mutual fund assets.

(*) = less than 0.5 percent

Note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds. Row percentages may not add to 100 percent because of rounding.

Sources: Investment Company Institute and Lipper

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