

## ICI VIEWPOINTS

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## The Facts on Fees and 401(k)s

By Mike McNamee

*Fourth in a [series of Viewpoints postings](#) on key facts about the 401(k) and the American retirement system*

Consistently falling prices in a marketplace are usually a sign of competition and innovation. Think about technology products, for example—the computer you can buy today almost certainly costs less and does more than the computer you could have bought a year ago, while the one you will be able to buy a year now from will be better and cheaper still.

Thanks to innovation, increasing transparency, and the dynamics of a highly competitive market, 401(k) mutual fund fees also have been falling—even as plans offer more and better services to participants. Let's take a closer look.

### Fees Pay for Services That Are Valuable to Investors

In any discussion of fees, it's important to start with a key notion: *all* forms of savings and investment come with costs. Investors incur these costs through fees, spreads, or reduced returns.

The situation is no different for retirement savings systems—including defined contribution (DC), defined benefit (DB) pension, or hybrid approaches. Among other things, fees cover the cost of investment management and associated administrative services (such as custodial, legal, transfer agent, and recordkeeping services) that are essential to operating retirement plans and safeguarding assets.

As anyone with a 401(k) knows, plans also provide educational materials to participants through mailings, brochures, website information, and tools and calculators. This information is important and valuable—nine in 10 households that own DC retirement plans (such as 401(k) plans) say that having an employer-sponsored retirement account helps them think about the long term, not just their current needs.

How does one get a handle on what all this costs? Deloitte and ICI conducted a study to determine the [average annual fees for 401\(k\) plans in 2011](#), totaling all administrative, recordkeeping, and investment fees, and found that the median participant-weighted “all-in” fee for plans was 0.78 percent of assets. That's 78 cents for every \$100 in assets—or approximately \$248 per year, per participant.

### Investors Are Sensitive to Fees in a Very Competitive 401(k) Market

When it comes to fees, 401(k) plan participants have several forces working in their favor. One is that the 401(k) market is highly competitive, with many types of providers vying for market share. Another is technology, which enables providers to operate more efficiently and lower costs.

Yet another is the price sensitivity of plan sponsors and plan participants themselves. For example, ICI research finds that 401(k) investors in mutual funds tend to hold lower-cost funds with below-average portfolio turnover. The average total expense ratio incurred by 401(k) investors in equity funds was 0.63 percent in 2012, less than half of the simple average of 1.40 percent for all equity funds and lower than the industrywide asset-weighted average of 0.77 percent.

Such results aren't surprising in the broader context of the fund industry. [Fees for mutual funds have fallen substantially over the past two decades](#), and mutual funds account for [about 60 percent of 401\(k\) assets](#).

## The Fund Industry Has Long Supported Transparency of Fees

Transparency of fees also has played a key role in keeping 401(k) costs in check—and will continue to do so. The fund industry, a long-time proponent of improving the transparency of fees, strongly supported [the rules on participant disclosure](#) from the U.S. Department of Labor (DOL)—including detailed fee disclosure—that went into effect in 2012.

The 2012 rules require that *all* 401(k) investments feature the same level of transparency regarding fees that [has long been required of mutual funds](#) through the prospectus requirement. For example, other investment vehicles now must disclose information already provided by mutual funds, such as expense ratios, management and other fees, and performance data. This disclosure will help plan sponsors and participants understand what they are getting for the fees they pay. The new DOL rules also require disclosure of risks, returns, investment objectives, and identity of investment providers—all of which should be considered in addition to the absolute level of the fees.

## Trading Costs: What to Consider

The discussion around 401(k) expenses often turns to trading costs. Here again, it's important to remember that 401(k) participants are investors, and being an investor means incurring, either explicitly or implicitly, costs associated with buying, selling, and holding investments (such as brokerage commissions or bid-ask spreads).

Plan sponsors, investment providers, and regulators alike agree that trading costs are an important issue. In fact, DOL regulations indicate that the level of trading (how frequently a pooled investment buys or sells securities) is a factor that plan fiduciaries should consider in selecting investments. ICI agrees that the fiduciary should consider the potential trading activity in a pooled investment product when considering the appropriateness of that product.

401(k) plan assets tend to be invested in funds that have lower-than-median levels of securities trading, and thus are likely to bear lower-than-median trading costs. For example, one-quarter of the assets in 401(k) plans are invested in some type of fixed-income product, such as guaranteed investment contracts and money market funds, which tend to rely heavily on liquid cash instruments and other investment strategies, rather than on trading securities, to meet investor flows.

*For more key information on retirement, please visit our [Retirement Resource Center](#) or read the other entries in this Viewpoints series:*

- [No Accident: The Strengths of the 401\(k\) System](#)
- [401\(k\) Plans Work in a Balanced Approach to Retirement Security](#)
- [The Facts on Limited Access to Retirement Funds Before Retirement](#)
- [The Facts on Fees and 401\(k\)s](#)
- [Americans Support Their 401\(k\)s](#)

Mike McNamee is ICI's chief public communications officer.