STATEMENT OF THE INVESTMENT COMPANY INSTITUTE
SARAH HOLDEN, SENIOR DIRECTOR, RETIREMENT & INVESTOR RESEARCH

ERISA ADVISORY COUNCIL WORKING GROUP ON
APPROACHES FOR RETIREMENT SECURITY IN THE UNITED STATES

The Investment Company Institute (ICI)[1] appreciates the opportunity to appear before the ERISA Advisory Council. The Council has asked us to present research and make any recommendations about assets in individual retirement accounts (IRAs). This testimony focuses on specific questions posed by the Council regarding the role of IRAs in U.S. households' retirement planning; the fees associated with mutual funds held in IRAs; the role of advice for IRA-owning households; and what information is provided by employers and IRA providers to plan participants regarding portability and rollovers. To address these issues, this testimony presents data drawn from a variety of sources including the Federal Reserve Board, the Internal Revenue Service Statistics of Income Division, the Department of Labor (the "Department"), and surveys fielded by ICI. This written statement is submitted in conjunction with testimony of Sarah Holden, Senior Director, Retirement and Investor Research, before the Council on September 17, 2009.

IRAs hold a significant portion of the retirement savings of American workers. They were created in 1974 under the Employee Retirement Income Security Act (ERISA) for the purpose of allowing workers without access to workplace retirement plans to save for retirement and as a vehicle for holding retirement assets after leaving employment. Today, a large portion of the assets currently held in IRAs are attributable to rollovers from employer-sponsored plans. This is, in part, because IRA contribution limits historically have been small in comparison to the amounts employers and participants could contribute to employer-sponsored plans. It also may be attributable to the fact that IRA eligibility rules are complex and many taxpayers who remained eligible to make tax-deductible contributions after the eligibility rules were tightened in 1986 discontinued doing so.

Section I of this testimony describes the role of IRAs in U.S. households' retirement savings and summarizes research on the distribution decisions retirement plan participants make when leaving an employer or retiring. Research finds that older participants with larger account balances are more likely to preserve assets at job change or retirement (either by leaving them in the plan or rolling into IRAs or another employer's plan). Many retiring defined contribution (DC) plan participants seek advice with these decisions. In addition, in any given year, few households that own traditional IRAs take distributions and the majority of those taking distributions indicate they are retired. Section II explores the asset composition of IRAs and the mutual fund expenses for IRA investors' mutual fund holdings. Forty-five percent of IRA assets were invested in mutual

[1] The Investment Company Institute (ICI) is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.02 trillion and serve more than 93 million shareholders. ICI's mutual fund members manage more than 40 percent of defined contribution plan and IRA assets and advocate policies to make retirement saving more effective and secure.

funds at year-end 2008, and IRA mutual fund assets were concentrated in lower-cost funds. Section III highlights the services shareholders receive when they seek financial advice.

Section IV of this testimony reviews the requirements imposed on plans to provide information to participants to assist them in making distribution decisions and the applicable law and rules governing IRA providers, including the disclosures they are required to make to IRA investors. It also describes certain obligations under the federal securities laws and ERISA on financial planners, advisers, and brokers in advising individuals about IRAs. Our analysis finds that plan participants receive information explaining the consequences of taking a distribution from a plan and rolling it into an IRA and that all IRA investors receive information on fees and other features associated with their IRA and periodic reports on the status of their accounts. While plan participants are well-served by these disclosures, Section V suggests that the Department could consider certain steps to encourage employers to provide education and information to participants making distribution decisions.

I. Background on IRAs

First created under ERISA, IRAs have grown to be the largest single component of the U.S. retirement system. IRAs were designed to be both contributory retirement accounts and rollover vehicles for assets accumulated in employer-sponsored retirement plans. IRAs represented one-quarter of all U.S. retirement wealth[2] and 9 percent of U.S. households' financial assets at year-end 2008,[3] holding $3.6 trillion in assets (Figure 1). Traditional IRAs were 90 percent of total IRA assets, holding $3.2 trillion at year-end 2008.[4] Although contributions played a significant role in the growth in traditional IRAs in the early-to-mid 1980s,[5] more recent growth has resulted in large part from rollovers into IRAs from employer-sponsored retirement plans. Internal Revenue Service (IRS), Statistics of Income data indicate that rollovers to traditional IRAs

[2] At year-end 2008, total IRA assets were $3.6 trillion and total retirement market assets were $14.1 trillion. Estimates for the total retirement market are available through 2009:Q1. At the end of the first quarter of 2009, total IRA assets were $3.4 trillion and total retirement market assets were $13.4 trillion (see Investment Company Institute, "The U.S. Retirement Market, First Quarter 2009," *Investment Company Institute Fundamentals* 18, no. 5-Q1 (August 2009); available at www.ici.org/pdf/09_q1_retmrkt_update.pdf). At the end of the first quarter of 2009, IRAs were still the single largest component of U.S. retirement assets (representing 25 percent of the total). This testimony will focus on the year-end 2008 data because mutual fund fee information is available through year-end 2008. (For additional detail on ICI's retirement data collection, see Brady, Holden, and Short, "The U.S. Retirement Market, 2008," *Investment Company Institute Fundamentals* 18, no. 5 (June 2009); available at www.ici.org/pdf/fm-v18n5.pdf.)

[3] At year-end 2008, U.S. households' financial assets were $41.2 trillion (see Federal Reserve Board, "Flow of Funds Accounts of the United States," *Z.1 Release* (June 2009), Washington, DC: Federal Reserve Board; available at www.federalreserve.gov/releases/z1/current/default.html).

[4] See Investment Company Institute, "The U.S. Retirement Market, First Quarter 2009."

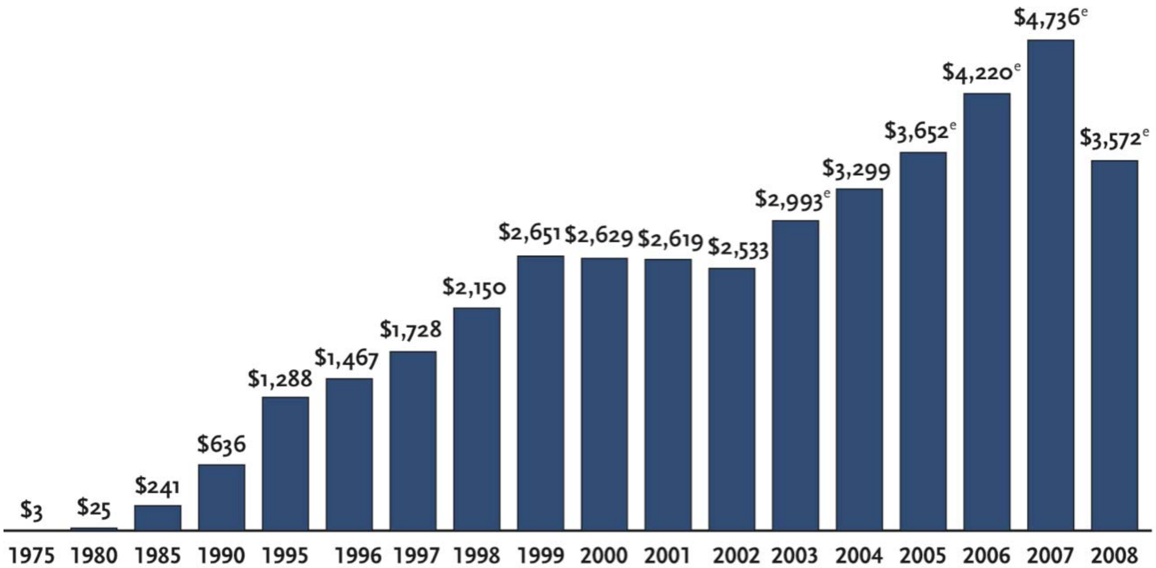
[5] For a discussion of the history of IRAs, see Holden, Ireland, Leonard-Chambers, and Bogdan, "The Individual Retirement Account at Age 30: A Retrospective," *Investment Company Institute Perspective* 11, no. 1 (February 2005); available at www.ici.org/pdf/per11-01.pdf.

totaled $215 billion in 2004 (latest data available).[6] ICI tabulation of Federal Reserve Board Survey of Consumer Finances data finds that about half of traditional IRA assets in 2007 were reported by households to be the result of rollovers.[7]

Figure 1

Total IRA Assets

Billions of dollars, year-end, selected years



e *Data are estimated.*

*Sources: Investment Company Institute, Federal Reserve Board, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division (*Fundamentals*, "The U.S. Retirement Market, First Quarter 2009" [www.ici.org/pdf/09_q1_retmrkt_update.pdf])*

In 2008, ICI household survey information indicates that 47.3 million, or 40.5 percent of, U.S. households held IRAs (Figure 2).[8] Traditional IRAs were the most common type of IRA owned, with nearly one-third of U.S. households indicating they owned traditional IRAs in May 2008. Sixteen percent of U.S. households reported Roth IRA ownership and almost one in 10 reported employer-sponsored (SEP, SAR-SEP,

[6] For detailed information from IRS Form 5498 tabulations for 2004, see Bryant, "Accumulation and Distribution of Individual Retirement Arrangements, 2004," *Statistics of Income Bulletin* (Spring 2008): 90–101, Washington, DC: IRS Statistics of Income Division; available at www.irs.gov/pub/irs-soi/04inretirebul.pdf.

[7] See Investment Company Institute, "The U.S. Retirement Market, First Quarter 2009."

[8] Data on the number and percentage of U.S. households owning IRAs are based on ICI's Annual Mutual Fund Shareholder Tracking Survey conducted in May 2008 of 4,100 randomly selected, representative U.S. households, whether they own mutual funds or not. The survey collects information on a variety of asset categories and retirement plan and education savings, in addition to demographic data. The standard error for the total sample is ±1.5 percentage points at the 95 percent confidence level. For further discussion and additional results from this survey, see Holden, Bogdan, and Bass, "Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2008," *Investment Company Institute Fundamentals* 17, no. 6 (December 2008); available at www.ici.org/pdf/fm-v17n6.pdf.

SIMPLE) IRA ownership. Among traditional IRA–owning households, more than half indicated their IRAs contained rollovers from employer-sponsored retirement plans and among those with rollovers more than half had made contributions to their traditional IRAs as well.[9]

Figure 2

U.S. Household Ownership of IRAs

	Year created	Number of U.S. households with type of IRA, 2008	Percentage of U.S. households with type of IRA, 2008
Traditional IRA	1974 (Employee Retirement Income Security Act)	37.5 million	32.1%
SEP IRA	1978 (Revenue Act)	10.0 million	8.6%
SAR-SEP IRA	1986 (Tax Reform Act)		
SIMPLE IRA	1996 (Small Business Job Protection Act)		
Roth IRA	1997 (Taxpayer Relief Act)	18.6 million	15.9%
Any IRA		47.3 million	40.5%

Note: Households may own more than one type of IRA.

*Sources: Investment Company Institute and U.S. Census Bureau (*Fundamentals*, "The Role of IRAs in U.S. Households' Saving for Retirement, 2008" [www.ici.org/pdf/fm-v18n1.pdf])*

[9] For characteristics and activity around contributions, rollovers, and withdrawals of U.S. households owning IRAs, see Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2008," *Investment Company Institute Fundamentals* 18, no. 1 (January 2009); available at www.ici.org/pdf/fm-v18n1.pdf. The 2008 ICI IRA Owners Survey, conducted in May 2008, collected information from 800 randomly selected, representative U.S. households owning traditional IRAs, Roth IRAs, and employer-sponsored IRAs (SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs). The standard error for the total sample is ±3.5 percentage points at the 95 percent confidence level. IRA ownership does not include ownership of Coverdell Education Savings Accounts (formerly called Education IRAs).

Data on Plan Participants' Activities at Job Change and Retirement

Individual choice plays an important role in the decision at job change or retirement to leave money in the current employer's plan, roll over to the next employer's plan (if the plan accepts rollovers), roll over to an IRA, purchase an annuity, cash out, or do some combination of these options. While DC plan participants typically have account balances available for rollover or lump-sum distribution, it is increasingly the case that defined benefit (DB) plan participants have access to an accumulated account balance.[10] Employee Benefit Research Institute (EBRI) tabulations of Survey of Income and Program Participation (SIPP) data, which cover distributions from both DB and DC plans, find that older participants and those with larger account balances are more likely to preserve accumulated retirement account balances at job change or retirement.[11] In addition, the analysis reports that an increasing percentage of retirement plan participants are rolling over all of their lump-sum distributions at job change.

DC plan recordkeeper data have been used to study the distribution activity of DC plan participants over time. For example, data covering the DC plans recordkept by The Vanguard Group indicate that the propensity to preserve accumulated balances by leaving them in the plan has increased over time.[12] Among participants terminating with their current employer in 2000, 29 percent left the money in the plan and 35 percent rolled the money over to an IRA or a new employer's plan. Among participants terminating with their current employer in 2008, 48 percent left the money in the plan and 21 percent rolled the money over to an IRA or a new employer's plan. Participant activity in 2001 observed by Fidelity Investments highlighted that more former employees of large employers left their accounts in the plan compared with former employees of

[10] In 1997, only 23 percent of full-time employees in DB plans offered by medium and large business establishments were in plans that allowed lump-sum distributions at retirement (see U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in Medium and Large Private Establishments*, *1997,* Washington, DC: U.S. Department of Labor, Bureau of Labor Statistics (September 1999); available at www.bls.gov/ncs/ebs/sp/ebbl0017.pdf). By 2005, more than half of private-sector employees in DB plans were offered a full or partial lump-sum distribution option (see U.S. Department of Labor, Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry in the United States*, *2005,* Washington, DC: U.S. Department of Labor, Bureau of Labor Statistics (May 2007); available at www.bls.gov/ncs/ebs/sp/ebbl0022.pdf). In addition, U.S. Department of Labor, Employee Benefits Security Administration data find that cash balance plans represented 8 percent of private-sector DB plans, 28 percent of DB plan assets, and 26 percent of active DB plan participants in 2006 (see U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin Abstract of 2006 Form 5500 Annual Reports* (Version 1.0), Washington, DC: U.S. Department of Labor, Employee Benefits Security Administration (December 2008); available at www.dol.gov/ebsa/pdf/2006pensionplanbulletin.pdf).

[11] See Copeland, "Lump-Sum Distributions at Job Change," *Employee Benefit Research Institute Notes* 30, no. 1(January 2009); available at www.ebri.org/pdf/notespdf/EBRI_Notes_Jan09_Rollovers.pdf; and Copeland, "More Detail on Lump-Sum Distributions of Workers Who Have Left a Job, 2006," *Employee Benefit Research Institute Notes* 30, no. 7 (July 2009); available at www.ebri.org/pdf/notespdf/EBRI_Notes_07-July09.LSDs.pdf.

[12] See The Vanguard Group, *How America Saves 2009: A Report on Vanguard 2008 Defined Contribution Plan Data,* Valley Forge, PA: The Vanguard Group, Vanguard Center for Retirement Research (2009); available at https://institutional.vanguard.com/iam/pdf/HAS09.pdf.

smaller employers.[13] Both sets of data find similar patterns of rollover and cash-out by participant age and account balance indicated by the SIPP data.

In late 2007, ICI surveyed recent retirees who had actively participated in DC plans (including 401(k), 403(b), and governmental DC plans) about how they used plan proceeds at retirement.[14][15] Respondents pursued a range of outcomes reflecting their own personal needs, in many cases rolling some or all of their account balances over to IRAs. In making their distribution decision, retirees with a choice of options often consulted multiple sources of information. Forty-two percent indicated they sought advice from a professional financial adviser that they found on their own. Three in 10 indicated they attended a seminar or workshop offered by their employer; 29 percent reviewed printed materials provided by their employer; and 13 percent used a professional financial adviser provided by their employer. Fifteen percent sought advice from a publication and 10 percent considered information provided in mutual fund company materials.

II. Investments Held in IRAs and Mutual Fund Expense Ratios

ICI estimates that IRA assets totaled $3.6 trillion at year-end 2008, with 45 percent, or $1.6 trillion, invested in mutual funds (Figure 3).[16] At year-end 2008, $310 billion (9 percent of the total) was invested in annuity products, $391 billion (11 percent of the total) was invested in deposits at commercial banks and savings institutions, and $1,275 billion (36 percent of the total) was invested in non-mutual fund investments through brokerage accounts, which could include exchange-traded funds (ETFs), stocks, bonds, and Treasury securities, among other investments. Within the mutual fund component, stock funds represented the bulk of mutual fund assets held in IRAs. At year-end 2008, 68 percent of mutual fund assets held in IRAs were stock funds (i.e., domestic equity, foreign equity, and hybrid funds). Bond funds accounted for 14 percent of IRA mutual fund assets and money market funds were 17 percent.

It is not possible for ICI to assess the total cost of owning IRAs. IRA assets are invested through a variety of venues; many of the assets in IRAs are in accounts for which ICI does not have fee information. It is possible, however, for ICI to analyze the expense ratios of the mutual fund assets held in IRAs.

[13] See summary of data presented in Miller, "The Ongoing Growth of Defined Contribution and Individual Account Plans: Issues and Implications," *Employee Benefit Research Institute Issue Brief*, no. 243 (March 2002); available at www.ebri.org/pdf/briefspdf/0302ib.pdf.

[14] For the complete report, see Sabelhaus, Bogdan, and Holden, "Defined Contribution Plan Distribution Choices at Retirement: A Survey of Employees Retiring Between 2002 and 2007," *Investment Company Institute Research Series* (Fall 2008); available at www.ici.org/pdf/rpt_08_dcdd.pdf.

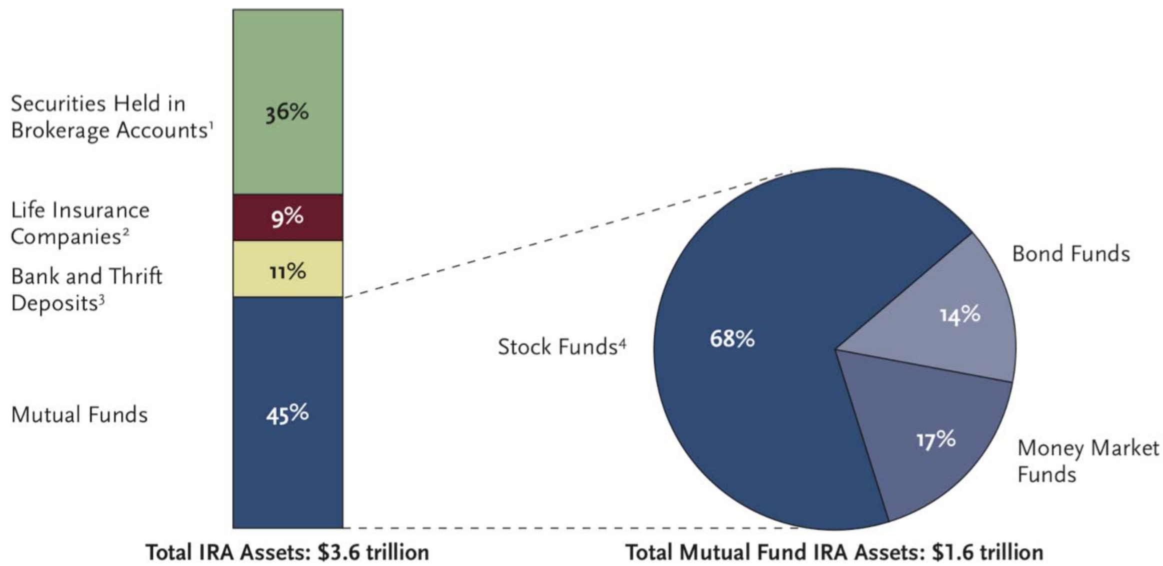
[15] For additional discussion of the retirement distribution phase, see previous ICI testimony on this topic: "Statement of the Investment Company Institute, Sarah Holden, Senior Director, Retirement & Investor Research, ERISA Advisory Council Working Group on Spend Down of Defined Contribution Plan Assets at Retirement;" available at www.ici.org/policy/retirement/retirement/08_dol_erisa_tmny.

[16] See footnote 2.

Figure 3

45 Percent of IRA Assets Were Invested in Mutual Funds at Year-End 2008

Percentage of assets, year-end 2008



[1]*Securities held in brokerage accounts exclude mutual fund assets held through brokerage accounts, which are included in mutual funds.*
[2]*Life insurance company IRA assets are annuities held by IRAs, excluding variable annuity mutual fund IRA assets, which are included in mutual funds.*
[3]*Bank and thrift deposits include Keogh deposits.*
[4]*Stock funds include hybrid mutual funds, which account for 15 percent of total IRA mutual fund assets.*

Note: Data are estimated for securities held in brokerage accounts, life insurance companies, and total IRA assets at year-end 2008.

*Sources: Investment Company Institute, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division (*Fundamentals, *"The U.S. Retirement Market, First Quarter 2009," [www.ici.org/pdf/09_q1_retmrkt_update.pdf])*

Looking at Mutual Fund Expense Ratios

Mutual funds incur a variety of expenses, including expenses relating to portfolio management, fund administration and compliance, shareholder services, recordkeeping, distribution charges, and other day-to-day operations.[17] Various factors affect a mutual fund's expense ratio, including its investment objective, its level of assets, the average account balance of its investors, and the range of services it offers. Mutual funds are required by law to disclose their expenses and report fund performance net of expenses. Fund expenses are reported as a percentage of fund assets, and this ratio is referred to as the fund expense ratio.

[17] For further description of mutual fund fees, see U.S. Securities and Exchange Commission, "Mutual Fund Fees and Expenses;" available at www.sec.gov/answers/mffees.htm, and Investment Company Institute, *2009 Investment Company Fact Book: A Review of Trends and Activity in the Investment Company Industry* (2009); available at www.icifactbook.org.

As part of ongoing research, ICI maintains a database to study trends in fund expense ratios.[18] In addition, ICI separately tracks IRA holdings of mutual funds.[19] The analysis here combines the results of these studies in order to examine the average fund expense ratio—calculated as an asset-weighted average—that investors incurred on mutual funds held in IRAs at year-end 2008. Under this approach, funds with larger shares of IRA mutual fund assets carry a proportionately greater weight in the summary fund expense ratio measure than do less widely held funds. This measure provides an aggregate estimate of what IRA mutual fund owners as a group paid, on average, to invest in mutual funds through their IRAs. This analysis finds that IRA mutual fund owners tend to concentrate their assets in lower-cost mutual funds.

IRA Owners Hold Lower-Cost Mutual Funds

Stock funds. Sixty-eight percent of IRA assets invested in mutual funds were invested in stock funds at year-end 2008 (Figure 3).[20] Mutual fund shareholders generally are sensitive to fund expense ratios.[21] New sales and assets tend to be concentrated in lower-cost funds, providing a market incentive for mutual funds to offer their services at competitive prices.[22]

Like mutual fund shareholders generally, IRA owners tend to hold lower-cost mutual funds. The average fund expense ratio incurred by IRA investors in stock funds was 0.82 percent (or 82 basis points) in 2008, much lower than the 1.44 percent simple average for all stock funds (Figure 4). The industrywide asset-weighted average for stock funds was 0.84 percent in 2008.

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[18] For the most recent report on mutual fund fees and expenses, see Collins, "Trends in the Fees and Expenses of Mutual Funds, 2008," *Investment Company Institute Fundamentals* 18, no. 3 (April 2009); available at www.ici.org/pdf/fm-v18n3.pdf.

[19] See Investment Company Institute, "The U.S. Retirement Market, First Quarter 2009," and Brady, Holden, and Short, "The U.S. Retirement Market, 2008."

[20] Stock mutual funds include domestic stock funds (41 percent of total IRA mutual fund assets at year-end 2008), foreign stock funds (12 percent), and hybrid funds (15 percent). Lifestyle and lifecycle funds are generally included in the hybrid fund category. See Investment Company Institute, "The U.S. Retirement Market, First Quarter 2009," and Brady, Holden, and Short, "The U.S. Retirement Market, 2008" for details.

[21] In February–March 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, *Understanding Investor Preferences for Mutual Fund Information* (2006); available at www.ici.org/pdf/rpt_06_inv_prefs_full.pdf). On average, recent mutual fund investors considered nine distinct items of information about a mutual 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 mutual fund investors wanted to know about a fund's fees and expenses before purchasing shares.

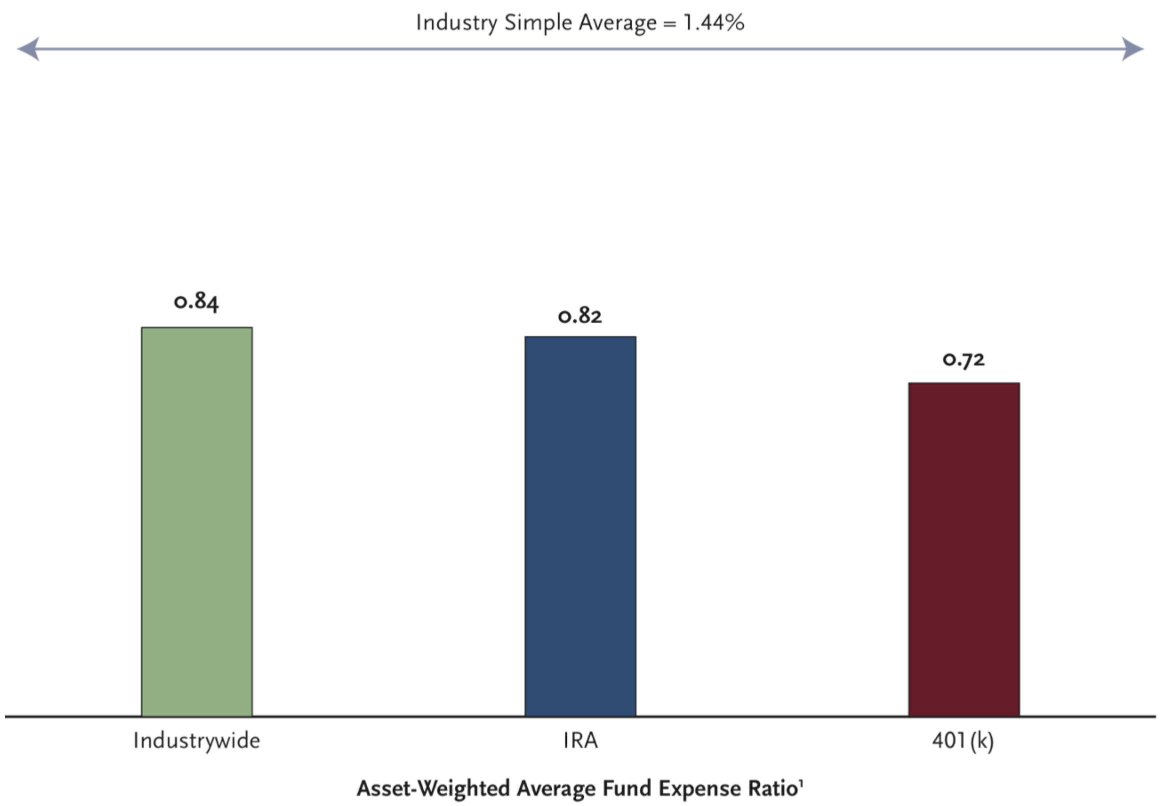
[22] See Investment Company Institute, *2009 Investment Company Fact Book: A Review of Trends and Activity in the Investment Company Industry*.

Mutual fund investors in 401(k) plans also have concentrated their assets in lower-cost funds. The average fund expense ratio incurred by 401(k) investors in stock funds was 0.72 percent in 2008.[23]

Figure 4

IRA Investors Concentrate Their Assets in Lower-Cost Stock Funds

Asset-weighted average fund expense ratio,[1] percent, 2008



[1]The asset-weighted average fund expense ratio is the mutual funds' expense ratios weighted by the assets of the type of account holder indicated. The fund expense ratio is reported as a percentage of fund assets.

Note: Stock mutual funds include hybrid funds. Figures exclude mutual funds available as investment options in variable annuities.

Sources: Investment Company Institute and Lipper

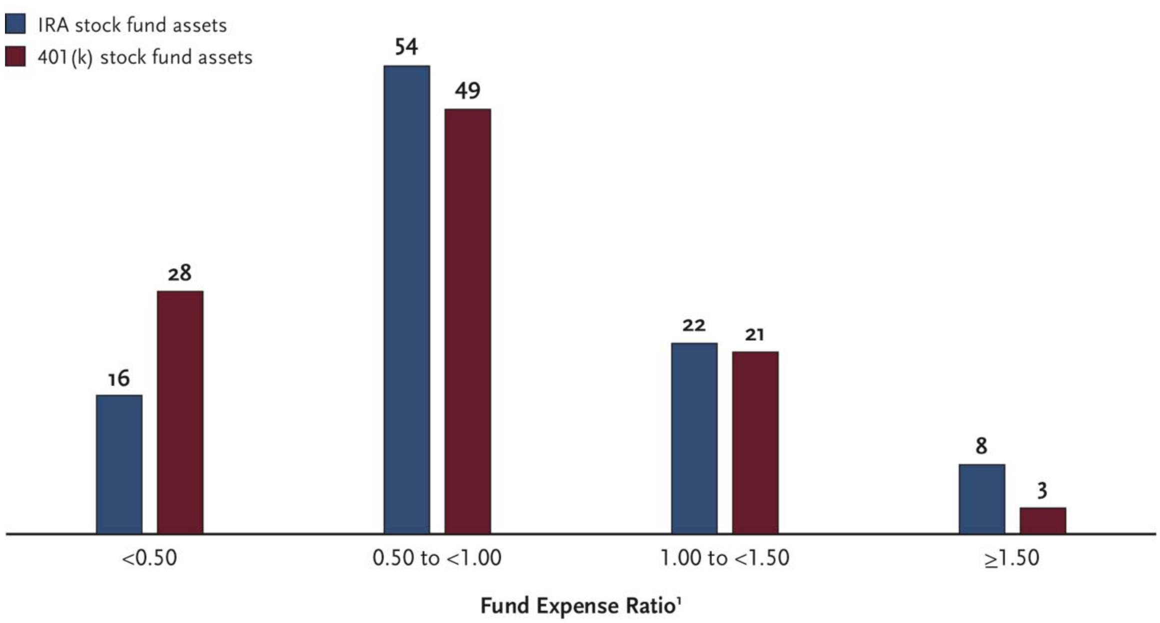
Expense ratios varied among the mutual funds that IRA owners hold. Seventy percent of IRA stock fund assets were invested in mutual funds with expense ratios less than 1 percent of assets at year-end 2008 (Figure 5). Sixteen percent of IRA stock fund assets were in mutual funds with expense ratios less than 0.50 percent. Stock mutual fund assets of 401(k) investors also were concentrated in lower-cost funds; 77 percent of 401(k) stock fund assets were invested in mutual funds with expense ratios less than 1 percent at year-end 2008, with 28 percent in stock funds with expense ratios less than 0.50 percent.

[23] For the complete report on mutual fund fees in 401(k) plans, see Holden and Hadley, "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2008," *Investment Company Institute Fundamentals* 18, no. 6 (August 2009); available at www.ici.org/pdf/fm-v18n6.pdf.

Figure 5

IRA and 401(k) Stock Mutual Fund Assets Are Concentrated in Lower-Cost Funds

Percentage of stock mutual fund assets, 2008



[1] *The fund expense ratio is reported as a percentage of fund assets.*

Note: Stock mutual funds include hybrid funds. Figures exclude mutual funds available as investment options in variable annuities. Percentages may not add to 100 percent because of rounding.

Sources: Investment Company Institute and Lipper

The lower average expense ratios incurred by 401(k) participants reflect many factors. For example, some plan sponsors choose to cover a portion of 401(k) plan costs.[24] Furthermore, many 401(k) plans have large

[24] See Holden and Hadley, "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2008." In addition, for a study exploring the mechanics of plan fee structures, components of plan fees, and primary and secondary factors that impact total 401(k) plan fees ("fee drivers"), see Deloitte Consulting LLP and Investment Company Institute, *Defined Contribution/401(k) Fee Study* (2009); available at www.ici.org/pdf/rpt_09_dc_401k_fee_study.pdf and *Appendix: Regression Analysis for the Deloitte/ICI Defined Contribution/401(k) Fee Study* (2009); available at www.ici.org/pdf/rpt_09_dc_401k_fee_study_app.pdf. In late 2008, Deloitte conducted a confidential, no-cost, web-based survey of plan sponsors. 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 represents the bottom line in terms of all administrative and investment-related fees for each plan. The "all-in" fee incorporates all administration, 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. 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, 130 plans participated in the 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 (e.g., average account balance, number of investment options, average participant contribution rate, asset allocation, plan design). Although Deloitte and ICI believe the survey results are representative, they cannot be projected to the entire population of U.S. 401(k) plans.

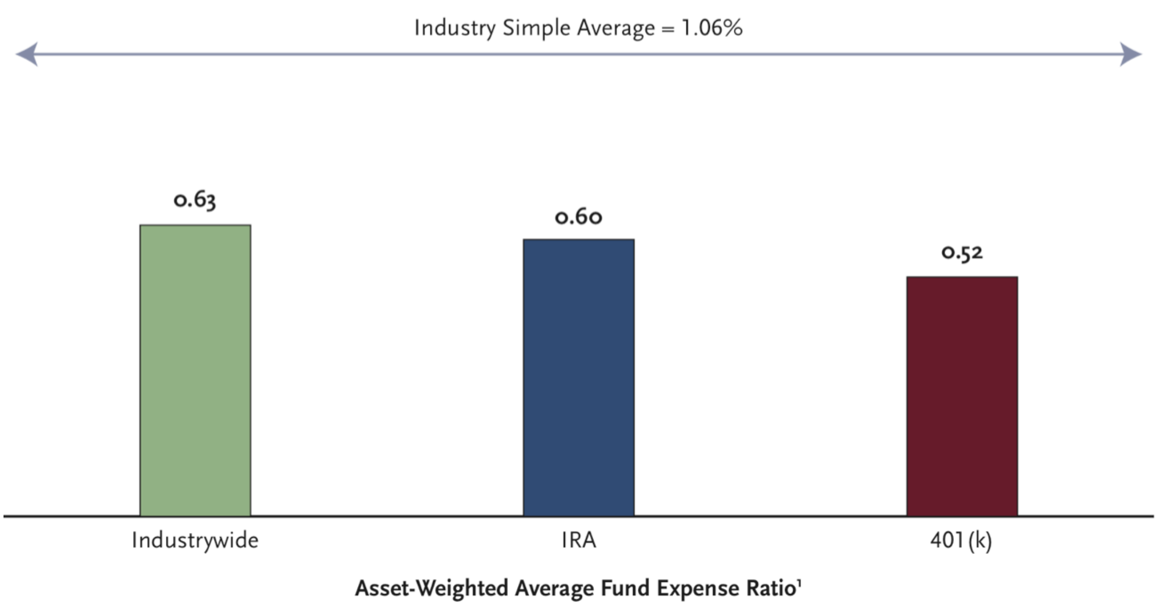
average account balances, and such economies of scale help to reduce the expense ratios of the funds offered in these plans. Finally, unlike shareholders outside of 401(k) plans who typically pay for the assistance of a financial adviser when investing in mutual funds,[25] there is a more limited role for such financial adviser services inside these plans. Many IRA owners, like many retail mutual fund investors, solicit financial advice when investing.

Bond funds. Fourteen percent of IRA mutual fund assets were invested in bond funds at year-end 2008 (Figure 3), and IRA bond fund investors also have concentrated their assets in lower-cost bond funds. At year-end 2008, IRA bond fund investors incurred an average expense ratio of 0.60 percent, compared with the 1.06 percent industrywide simple average (Figure 6). As was the case with stock funds, the asset-weighted average fund expense ratio for IRA bond fund investors falls between the asset-weighted industry average (0.63 percent) and the 401(k) asset-weighted average (0.52 percent).

Figure 6

Expense Ratios for Bond Mutual Funds

Asset-weighted average fund expense ratio,[1] percent, 2008



[1]The asset-weighted average fund expense ratio is the mutual funds' expense ratios weighted by the assets of the type of account holder indicated. The fund expense ratio is reported as a percentage of fund assets.

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

Sources: Investment Company Institute and Lipper

Money market funds. Seventeen percent of IRA mutual fund assets were invested in money market funds at year-end 2008 (Figure 3). For IRA owners holding money market funds, their average fund expense

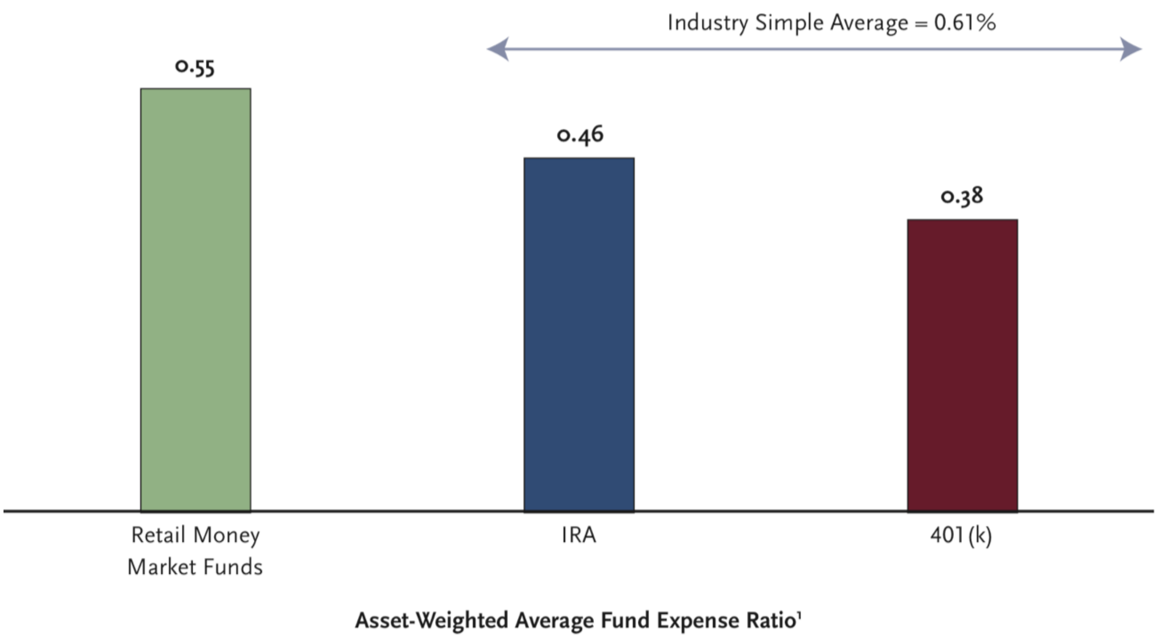
[25] Among mutual fund shareholders owning funds outside of DC plans, 80 percent owned fund shares through professional financial advisers in 2007 (see Schrass, "Ownership of Mutual Funds Through Professional Financial Advisers, 2007," *Investment Company Institute Fundamentals* 17, no. 4 (September 2008); available at www.ici.org/pdf/fm-v17n4.pdf).

ratio was 0.46 percent of assets in 2008, compared with an industrywide simple average of 0.61 percent and an asset-weighted average fund expense ratio of 0.55 percent for retail money market funds (Figure 7).

Figure 7

Expense Ratios for Money Market Funds

Asset-weighted average fund expense ratio,[1] percent, 2008



[1]The asset-weighted average fund expense ratio is the mutual funds' expense ratios weighted by the assets of the type of account holder indicated. The fund expense ratio is reported as a percentage of fund assets.

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

Sources: Investment Company Institute and Lipper

III. <u>Some Shareholders Use Financial Advisers</u>

Professional financial advisers provide a wide array of investment and planning services to investors. Financial advisers generally help investors identify financial goals and recommend funds to meet those goals. They also provide a range of services to investors after the initial sale of fund shares, including conducting transactions, maintaining financial records, and coordinating the distribution of prospectuses, financial reports, and proxy statements.

The Investment Company Institute undertook a comprehensive survey in 2006 to examine mutual fund shareholders' use of ongoing, professional investment advice.[26] For this testimony, ICI tabulated results

[26] The ICI Mutual Fund Shareholders' Use of Advice Survey in 2006 was based on a sample of 1,003 randomly selected households owning mutual funds outside workplace retirement plans, of which 602 had ongoing advisory relationships. The survey sample was drawn from telephone exchanges with median household incomes of $75,000 or more. The average household income of households owning funds outside workplace retirement plans was roughly $75,000. To identify mutual fund shareholders with ongoing advisory relationships, each survey respondent was asked whether he or she had an ongoing relationship with a professional financial adviser, who was defined as "someone who makes a living by providing investment advice and services." The overall sampling error for the

for a subset of mutual fund investors with ongoing advisory relationships in 2006—those who also reported ownership of traditional or Roth IRAs.[27]

Investment Services. The investment services range from portfolio analysis and asset allocation assistance to specific investment recommendations. Mutual fund shareholders who use advisers typically receive regular portfolio reviews and investment suggestions from their advisers. Among mutual fund investors with traditional or Roth IRAs and ongoing advisory relationships, 86 percent said their advisers regularly assessed their portfolios and gave them investment recommendations (Figure 8). About seven in 10 indicated their advisers helped them allocate assets held in workplace retirement plans.

Planning Services. Helping investors plan to achieve their financial goals is another valuable service that advisers provide. Eighty-six percent of mutual fund investors with traditional or Roth IRAs and ongoing advisory relationships said they had periodic discussions of their financial goals with their advisers (Figure 8). About three-quarters said they receive financial planning assistance from their primary advisers, and six in 10 received advice on how to manage assets in retirement. About half also indicated that they had access to tax planners and other types of specialists through their advisers.

survey is ± 4.0 percentage points at the 95 percent confidence level among households with ongoing advisory relationships. See Schrass, "Ownership of Mutual Funds Through Professional Financial Advisers, 2007;" and Leonard-Chambers and Bogdan, "Why Do Mutual Fund Investors Use Professional Financial Advisers," *Investment Company Institute Fundamentals* 16, no. 1 (April 2007); available at www.ici.org/pdf/fm-v16n1.pdf.

[27] These individuals may or may not own mutual funds inside their IRAs. The survey focused on advice received by individuals owning mutual fund outside of DC plans.

Figure 8

Shareholders Receive Numerous Investment Services from Professional Financial Advisers

Percentage of mutual fund–owning respondents with traditional or Roth IRAs and ongoing advisory relationships,[1] 2006

Types of services currently received from primary adviser[2]	
Investment services[2]	
Regular portfolio review and investment recommendations	86
Review of allocation of investor's employer-sponsored retirement plan assets[3]	71
Planning services[2]	
Periodic discussion of financial goals	86
Planning to achieve specific goals, such as saving for retirement or paying for college	77
Comprehensive financial planning	76
Managing assets in retirement	61
Access to specialists in areas such as tax planning	51
Number of services received	
One or two services	12
Three or four services	24
Five or more services	64

[1]*Responses of 457 households in the survey who had ongoing advisory relationships, owned mutual funds, and owned traditional or Roth IRAs.*
[2]*Multiple responses are included.*
[3]*Percentage reported is among respondents who reported ownership of employer-sponsored retirement plan assets.*

Source: Investment Company Institute Mutual Fund Shareholders' Use of Advice Survey

Investors seek such services for a number of reasons. About three-quarters of mutual fund shareholders with traditional or Roth IRAs and ongoing advisory relationships used advisers because they wanted help allocating their assets across different types of investments (Figure 9). Seventy-one percent said they wanted a financial professional to explain various investment options to them; 71 percent wanted the adviser to help them make sure they were saving enough to meet their financial goals; and 70 percent wanted help understanding their total financial picture. For two-thirds, making sure their estate was in order was a main reason for the advisory relationship.

Figure 9

Mutual Fund Owners Look to Advisers for the Expertise They Provide

Percentage of mutual fund–owning households with traditional or Roth IRAs and ongoing advisory relationships[1] indicating each is a "major" reason for using advisers,[2] 2006

[1]Responses of 457 households in the survey who had ongoing advisory relationships, owned mutual funds, and owned traditional or Roth IRAs.
[2]Multiple responses are included.
[3]Percentage reported is among respondents who reported ownership of employer-sponsored retirement plan assets.

Source: Investment Company Institute Mutual Fund Shareholders' Use of Advice Survey

ICI's IRA Owners Survey also highlights the role of advice for traditional IRA owners, particularly in the distribution phase.[28] Among households owning traditional IRAs in 2008 who took a withdrawal in tax-year 2007, 59 percent consulted a professional financial adviser to determine the amount to withdraw in tax-year 2007 (Figure 10). The second most-cited source of information for the distribution decision was IRS rules or publications, consulted by one-third of traditional IRA–owning households with withdrawals. IRA withdrawals were infrequent and mostly retirement related. Twenty-two percent of traditional IRA–owning households in 2008 had taken a withdrawal in tax-year 2007, and 82 percent of households that made traditional IRA withdrawals were retired.[29]

[28] See footnote 9 for information on ICI's IRA Owners Survey.

[29] See Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2008."

Figure 10

Households Often Consulted with a Professional Financial Adviser to Determine the Amount of Traditional IRA Withdrawals

Percentage of traditional IRA–owning households that made a withdrawal in tax-year 2007

Note: Multiple responses are included.
*Source: Investment Company Institute IRA Owners Survey, 2008 (*Fundamentals*, "The Role of IRAs in U.S. Households' Saving for Retirement, 2008" [www.ici.org/pdf/fm-v18n1.pdf])*

IV. <u>The Decision to Roll Over Plan Assets into an IRA</u>

The Internal Revenue Code sets out a comprehensive disclosure regime covering both plan sponsors and IRA providers with regard to information provided for distribution and rollover decisions. Plan sponsors must inform departing employees of information relevant to their distribution decision. IRA providers must disclose at the outset and on an ongoing basis the relevant information to IRA owners. In addition, financial planners, advisers or brokers may have fiduciary obligations or be subject to other rules of practice with regard to advice to clients on distribution and rollover decisions.

<u>Role of Plan Sponsor</u>

When an employee terminates his or her employment with the plan sponsor, the employee may have a choice of whether to leave his or her account balance (or accrued benefit in the case of a DB plan) in the plan, take a distribution in cash, or roll over the account or accrued benefit to another plan or IRA. If the plan provides that small accounts or accrued benefits (i.e., present value of $5,000 or less) will be distributed without the consent of the participant, the employer or plan administrator must automatically roll over the balance into an IRA if the balance exceeds $1,000, absent other direction from the participant.[30] The Department has provided a safe harbor under which fiduciaries will be deemed to have satisfied their fiduciary duties under section 404(a) of ERISA with respect to both the selection of an IRA provider and the investment of funds

[30] Internal Revenue Code §401(a)(31)(B).

within the IRA in connection with an automatic rollover of a mandatory distribution.[31] Conditions of the safe harbor include that the rolled-over funds shall be invested in an investment product designed to preserve principal and provide a reasonable rate of return; that the investment product selected for the rolled-over funds shall seek to maintain, over the term of the investment, the dollar value that is equal to the amount initially invested in the product; and that all fees and expenses of the IRA (including investments) shall not exceed the fees and expenses charged by the IRA provider for comparable IRAs established for reasons other than the receipt of an automatic rollover distribution. Plan participants must receive an explanation of the plan's automatic rollover provisions, including information on the investment of rolled-over funds, in an SPD (summary plan description) or SMM (summary of material modifications).

In cases where there is no mandatory distribution, but a participant is eligible to receive a distribution, the plan administrator must furnish certain notices that relate to the decision of whether to take a distribution and what to do with it.

<u>402(f) notice</u>

Under Code section 402(f), plan administrators of qualified plans must furnish a written notice to any participant receiving an eligible rollover distribution (which generally would include a lump-sum distribution) describing the rules for direct rollovers, income tax withholding on amounts not directly rolled over, tax treatment of these amounts, and special rules that may apply after amounts are directly rolled over into another plan or IRA. Under IRS regulations,[32] the notice must be given within a reasonable period of time before making the distribution, which would be no less than 30 days and no more than 180 days before the date of distribution (although participants can waive the 30 day period). The IRS offers a model notice that plan administrators can use and tailor to their own plans.[33] The model notice states that it is intended to help the participant decide whether to roll over the distribution. It explains that the IRA or plan receiving a rollover will determine the available investment options, fees, and payment rights. The notice also explains the different tax rules that will apply if a distribution from a plan is rolled over into an IRA, such as the additional exceptions to the early distribution penalty (e.g., qualified higher education expenses and qualified first-time home purchases) and the responsibility to track any after-tax amounts in the IRA.

<u>Notice of consequences of failure to defer</u>

Under IRS regulations,[34] for any distribution requiring the participant's consent, the participant first must be informed of the right, if any, to defer receipt of the distribution from the plan. The Pension Protection Act of 2006 (PPA) directed the IRS to modify this regulation to add a description of the consequences of

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[31] Labor Reg. §2550.404a-2.

[32] Treas. Reg. §1.402(f)-1, A-2 (as modified by section 1102 of PPA).

[33] The IRS's model notice is available at www.irs.gov/pub/irs-drop/n-09-68.pdf. The IRS recently revised the model notice to simplify the presentation of information to participants.

[34] Treas. Reg. §1.411(a)-11.

failing to defer receipt. Regulations proposed by the IRS in late 2008 are pending.[35] As the actual requirement to provide this description became effective for notices provided in plan years beginning after December 31, 2006, plans may rely on the proposed regulations until final regulations are effective. Under the proposed regulations, the requirement to inform participants of the consequences of failing to defer receipt of distribution would be satisfied by providing participants with the following information:

- Tax consequences: implications on taxable income of taking an immediate distribution that is not rolled over (or not eligible to be rolled over) as compared to deferring distribution; possible application of the 10 percent early distribution penalty tax under Code section 72(t); and, in the case of a DC plan, loss of the opportunity for future tax-favored treatment of earnings if the distribution is not rolled over (or not eligible to be rolled over) to an eligible retirement plan.

- DB plan options: a statement of the amount payable to the participant under the normal form of benefit both upon immediate commencement and upon deferred commencement (assuming no future benefit accruals).

- DC plan investment options: a statement that some currently available investment options in the plan may not be generally available on similar terms outside the plan and contact information for obtaining additional information on the general availability outside the plan of currently available investment options in the plan.

- DC plan investment fees: a statement that fees and expenses (including administrative or investment-related fees) outside the plan may be different from fees and expenses that apply to the participant's account and contact information for obtaining additional information on the fees and expenses that apply to the participant's account.

- Important plan terms: an explanation of any provisions of the plan that could reasonably be expected to materially affect a participant's decision whether to defer receipt of the distribution (such as loss of eligibility for retiree health coverage or early retirement subsidies if the participant elects not to defer a distribution).

Although this information must appear together, the proposed regulations would allow the notice to cross reference notices or other information provided or made available to a participant, as long as the participant is informed how the referenced information may be obtained without charge and the notice explains why the referenced information is relevant to a decision to defer. The notice must be provided no less than 30 days and no more than 180 days before the date the distribution commences (although participants can waive the 30 day period).

<u>Role of the IRA Provider</u>

IRA providers are subject to certain disclosure obligations under the Internal Revenue Code, as described below. Entities that serve as custodians to IRAs also are regulated depending on the type of entity. The FDIC regulates bank custodians and the IRS regulates non-bank custodians. Any entity that is not a bank must be approved by the IRS to serve as a non-bank trustee or custodian for IRAs or other types of retirement accounts. A prospective non-bank trustee or custodian must file an application demonstrating that it will meet

[35] Proposed Treas. Reg. §1.411(a)-11.

certain regulatory requirements[36] including that it has the ability to act within accepted rules of fiduciary conduct (demonstrating business continuity, an established location, fiduciary experience, fiduciary procedures, and financial responsibility); the capacity to account for the interests of a large number of individuals; and the fitness to handle retirement funds.

Regardless of the type of IRA provider, IRA owners must receive certain disclosures at establishment of the IRA and periodically thereafter. IRS regulations require IRA trustees/issuers to issue a disclosure statement and a copy of the governing instrument (e.g., the custodial agreement) to the owner at establishment of the IRA (and update these later with any amendments).[37] The disclosure statement must set forth in nontechnical language concise explanations of the requirements of Code section 408, the income tax consequences of establishing the account including the deductibility of contributions and tax treatment of distributions, the circumstances under which the account can be revoked, and certain statements regarding the consequences of engaging in a prohibited transaction, borrowing money from the account, taking early distributions, not taking required minimum distributions, making excess contributions, and other matters. The disclosure statement must also contain a financial disclosure about the potential value of the account at various points in the future, with different rules depending on whether the amount is guaranteed, a reasonable projection of growth can be made, or no amount is guaranteed and no projection can be made (i.e., a mutual fund investment or variable annuity). If no amount is guaranteed and no projection can be made, the financial disclosure should assume level annual contributions of $1,000 (or a rollover contribution of that amount, or both) and should describe in nontechnical language (1) each type of charge (and amount) which may be made against a contribution, (2) the method for computing and allocating annual earnings, and (3) each other charge which may be applied to the account in determining the net amount of money available to the owner (and method for computing such charges).

Beyond these requirements, particular investment products may have their own disclosure obligations. Mutual funds offered in IRAs, for example, are subject to the requirements of the federal securities laws, including the prospectus requirements of the Securities Act of 1933. There are also several annual reports that must be provided to IRA owners and the IRS, under IRS regulations and related guidance.[38] The trustee/issuer must report to the owner the fair market value of the IRA each year, as of calendar year end, by January 31 of the following year and any contributions made to the IRA for that calendar year by May 31 of the following year. Contribution and asset fair market value information is reported to the IRS on Form 5498, a copy of which can be used to satisfy the reporting requirements to the owner.[39] Distributions from IRAs are reported to both the owner and the IRS on Form 1099-R.[40] IRA trustees and issuers must also provide the owner with a

[36] Treas. Reg. §1.408-2(e)(2) through §1.408-2(e)(7).

[37] Treas. Reg. §1.408-6(d)(4).

[38] Treas. Reg. §1.408-5.

[39] IRS Form 5498 is available at www.irs.gov/pub/irs-pdf/f5498.pdf.

[40] IRS Form 1099-R is available at www.irs.gov/pub/irs-pdf/f1099r.pdf.

notice regarding required minimum distributions, if applicable, by January 31 of each year in which the owner is age 70-1/2 or older.[41]

Role of Other Parties

Financial planners, advisers or brokers may play a role in an individual's IRA investments. While not generally considered to be ERISA fiduciaries, these parties may have other fiduciary obligations or be subject to other rules of practice. For example, investment advisers are regulated and subject to fiduciary obligations to clients under the Investment Advisers Act of 1940 and/or under state adviser laws. These standards, meant to prevent advisers from overreaching or taking advantage of a client, require them to act in the client's best interest. The Advisers Act also imposes obligations on advisers relating to fees and advertising. Brokers, on the other hand, are subject to rules of fair practice and advertising rules under FINRA's jurisdiction. Securities recommendations of brokers must be suitable and appropriate for the customer and brokers must disclose conflicts of interest on a transactional basis.

The Department has issued guidance on the role of advisers hired by participants in participant-directed plans with respect to rollovers. In Advisory Opinion 2005-23A,[42] the Department stated that a financial planner or adviser hired by a participant, and not chosen nor promoted by the plan sponsor, may recommend rolling over an account balance to an IRA to take advantage of investment options not available under the plan, and then advise as to those external investments, without becoming a fiduciary under ERISA. The result would be different if the planner or adviser had provided advice with respect to investing the account balance in the plan, thereby becoming an ERISA plan fiduciary prior to recommending the rollover. In that case, if the IRA is managed by the same adviser, there may be a violation of the self-dealing rules of ERISA section 406(b)(1).

V. ICI Recommendations

There are many factors that may enter into a participant's decision to keep his or her assets in a previous employer's plan or to roll over those assets into an IRA or a new employer's plan. These include the range of investments available in the plan and the fees for those investments as compared to the range of investments and fees available in an IRA or new employer's plan; whether the participant has an immediate or on-going need for advice and where that advice might be available; any benefits of consolidating retirement assets in a single vehicle; the availability of Roth treatment; and any perceived desirability of maintaining the ability to take a plan loan.

Because there is no one-size fits all solution to managing assets at job change or retirement, it is important that participants understand the various options available to them. In our view, participants are well-served by the disclosure regime described above. In addition, many plans voluntarily offer education or advice

[41] Treas. Reg. §1.408-8, Q&A 10; Notice 2002-27, 2002-1 C.B. 814.

[42] See www.dol.gov/ebsa/regs/aos/ao2005-23a.html.

programs that can assist participants in deciding what action to take in connection with a retirement account upon leaving employment or retiring.

The Department can take steps to increase the availability of education to participants making decisions at job change or retirement. Today most of the information on the Department's website is geared to the accumulation stage of retirement saving. The Department may want to consider developing educational materials to help participants with distribution decisions at job change and retirement and make these materials prominent and accessible. The Department also should extend Interpretive Bulletin 96-1 to make clear that plan sponsors and service providers may convey the general advantages and disadvantages of various forms of distribution options without triggering fiduciary liability. This might encourage more plans to offer educational tools geared to distribution decisions.

* * *

IRAs play an important role in U.S. households' saving for retirement. At the juncture of job change or retirement, employer-sponsored plan participants select among a range of options, making choices that reflect their individual needs. Before receiving a distribution from an employer plan, participants leaving employment must receive disclosures describing the tax consequences of distributions and what advantages may be lost by not leaving assets in the plan. Many individuals choose to roll over plan assets to another employer-sponsored plan or IRA. IRA investors holding mutual funds have concentrated their mutual fund assets in lower-cost mutual funds in their IRAs. Among mutual fund–owning households with IRAs, those who consult financial advisers receive a wide range of investment and planning services, regular portfolio reviews, financial planning assistance, retirement asset management, and investment recommendations. Traditional IRA–owning households (whether they own mutual funds or not) often report that they consult financial advisers when determining the distribution amounts from their IRAs. IRA providers also must meet various disclosure obligations to IRA owners, including explaining any fees associated with the IRA. While the required disclosures for plans and IRAs are robust, additional guidance from the Department on the use of educational materials and tools could further improve participants' information set when making distribution decisions from employer-sponsored plans.

We thank the Council for allowing us this opportunity to share our data and submit our views.