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Fee Disclosure to Pension Participants:

Establishing Minimum Requirements

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Abstract

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Every year pension participants worldwide in defined contribution and individual account plans pay billions of dollars in fees. They need information concerning fees to make informed decisions about the services they are purchasing. To provide them that information, governments may need to mandate minimum requirements as to fee disclosure in defined contribution plans. This analysis of fee disclosure takes into account insights from behavioral economics in assessing the usefulness of different approaches. Standardizing types of fees and formats in which they are presented would facilitate comparisons across different investment options. Presenting fees paid in amount paid would provide useful information for participants lacking basic skills in computation. The report proposes a model fee disclosure. It creates a score card assessing the fee disclosure in six countries: Australia, Canada, Chile, Sweden, the United Kingdom, and the United States. While the cost of greater disclosure has been raised as an issue, the evidence indicates that the cost borne by participants would be small.

Fee Disclosure to Pension Participants:

Establishing Minimum Requirements

Every year pension participants worldwide in defined contribution and individual account plans pay billions of dollars in fees. These fees are primarily for investment expenses but also include administrative expenses. Participants generally are poorly informed about the fees they pay.

Fees would be of no policy consequence, however, if all mutual funds and other investment instruments in which pension participants invested charged competitive prices. In fact, mutual fund fees vary by an order of magnitude. The wide variability in the level of fees charged, combined with little evidence that high-cost funds outperform low-cost funds net of fees (Choi et al. 2006, Bauer et al. 2007), make adequate disclosure important for pension participants. As retirement income systems world wide move toward defined contribution and individual account plans, fees have an increasingly large impact on national and individual retirement savings.[1]

To provide participants the information they need to make informed decisions about the services they are paying for, government may need to mandate minimum requirements as to fee disclosure in defined contribution plans. Improved fee disclosure could reduce fees participants are paying by sensitizing participants to fees when choosing investments. Informed choice by pension participants could improve the competitiveness of the financial services industry, reducing the level of fees charged.

This discussion of policy concerning fee disclosure takes into account insights from behavioral economics in assessing the usefulness of different approaches. Behavioral economics has demonstrated that many pension participants are poorly informed on financial issues, including the role and importance of the fees they pay. Many lack basic computational skills. Taking into account this low level of financial and mathematical sophistication, the report proposes a model fee disclosure. It creates a score card assessing the fee disclosure in six countries.

In an Appendix, the report presents country studies for six countries. We have selected the six countries because they approach the regulation and disclosure of fees in different ways. The countries are Australia, Canada, Chile, Sweden, the United Kingdom, and the United States.

While information concerning the risks and expected returns of different investments should also be disclosed, the discussion focuses exclusively on disclosure of information about fees.

[1] In Canada and the United States, the term “fees and expenses” is generally used in prospectuses. In this paper, the term fees is used to denote the same meaning.

Fees Affect Account Balances

Fees can substantially affect pension account balances. Table 1 provides an example. This example was calculated using the U.S. Securities and Exchange Commission (SEC) on-line fees calculator, which is available at http://www.sec.gov/investor/tools/mfcc/get-started.htm . It shows that a difference in fees of 0.5 percentage points can cause a 10 per cent difference in account balances at the end of a 20-year period. An apparently small difference in fees thus can cause a sizable difference in account balances.[ii]

Table 1. Effect of fees on account balance		
Assumptions and results	**Expense ratio of 0.5%**	**Expense ratio of 1.0%**
Assumptions		
Amount of investment	$10,000	$10,000
Holding period	20 years	20 years
Annual rate of return	11%	11%
Results		
Total cost (fees plus foregone earnings)	$7,690.60	$14.680.91
Account balance at end of 20 years	$72,932.52	$65,942.21
Source: Author's calculations		

Types of Fees Charged to Participants

Pension fee structures can be complex. The U.S. Department of Labor (DOL) 401(k) Plan Fee Worksheet lists 38 definitions concerning fees and 36 types of fees that plans may incur (www.dol.gov/ebsa/pdf/401kfefm.pdf). Fees include sales commissions and trading costs, start-up costs, investment advice and management fees, administration, legal compliance, trusteeship fees, record-keeping fees, and termination or surrender charges. Participants may be charged fees for establishing an account, contributing to an account, switching between funds provided by a single mutual fund provider, assistance from a financial adviser, withdrawals from an account, and terminating an account.

Generally, the largest fees charged to pension participants are for managing their investments. These include fees for active management and fees for transactions (buying and selling the underlying assets). Fees for transactions differ considerably in amount between index funds, which have low transactions fees because of limited trading, and actively managed funds. Fees for establishing and terminating an account, charged in some systems, are typically flat fees. Fees as a percentage of assets tend to be lower for large plans, and sometimes for large accounts, than for small plans and accounts due to economies of scale.

Effectiveness of Fee Disclosures: Insights from Behavioral Economics

Economics can provide insights on the effectiveness of fee disclosures. Traditional economics focuses on rational decision-making by well-informed economic actors. It assumes information about the prices of different services is available at little cost. Applying this model to analyze disclosure to participants in pension plans, workers would make decisions based on knowing the fees they were paying and the fees being charged for alternative investments. Workers' knowledge as to fees would cause them to pick low-fee providers within different classes of investments. Choosing funds taking into account their fees would lead to competitive pressure on fund providers to reduce fees, and a competitive and efficient market for investments would result.

Behavioral economics, by contrast, incorporates psychological insights into how people behave with less than perfect information, understanding, and decision-making abilities. Behavioral economics focuses on decision-making where workers are not well-informed, where they lack financial knowledge and sophistication, and where they lack the interest to learn about financial market issues. Information about prices may not be readily available. As a consequence, workers make systematic and predictable mistakes (Turner 2003). The insights of behavioral economics can be applied to understand how to make fee disclosure more useful for pension participants.

Confusing Jargon vs. Plain English

Fee disclosure is often confusing because of jargon. Jargon is language that is not understood by the general population because of lack of specialized knowledge. Terminology that does not make logical sense can make disclosures confusing. Clear disclosure needs to be written in plain English and with the assumption of a low level of education. For example, the Joint Forum of Financial Market regulators in Canada has proposed that disclosures be written at a Grade 5 level.

Often mutual funds differentiate between fees and expenses. While it could be assumed that fees would be something that the investor would pay, it is not clear how that would be distinguished from expenses. That distinction is generally made in U.S. prospectuses. For example, that distinction is made by Franklin Templeton Investments, but to add to the confusion as to the difference, the items under expenses are management fees, 12b-1 fees and other expenses (including administrative fees), so every item under expenses is a fee. Some fees for buying shares are categorized as "loads", yet another example of jargon, where "sales fees" would be more readily understandable terminology.

Even the term "expense ratio" does not clearly state that those are fees the participant pays. Simply calling it "fees" or "fees you pay" would be clearer. Disclosures that indicate that the participant indirectly pays fees, meaning that the fees are charged to the participant's account rather than directly billed to the participant, create a distinction that adds to the potential for confusion. Other terminology that should be explained to pension participants includes passive investments, index funds, turnover, and benchmark (Members of Congress 2008).

Lack of Standardization of Terminology

With standardized terminology, the same terminology would be used to disclose fees by different service providers and for different products. Lack of standardization is another aspect of terminology that makes it difficult for pension participants to compare fees across mutual fund providers. For example, in comparing the three fund providers that Georgetown University in Washington, DC offers to its professors, TIAA-CREF uses the term “gross expense ratio,” Vanguard uses the term “expense ratio,” and Fidelity uses the term “total annual fund operating expenses.” It is difficult to determine from the material provided if these concepts are exactly comparable. Whether or not they are comparable, the terminology suggests that they are not.

Framing and Saliency

Confusing framing and lack of saliency can obfuscate the information communicated to participants. Presenting information within different contexts, or framing information, can affect how people interpret it. For example, people would expect important information to be presented before unimportant information. They would expect important information to be presented in easy to read font size, while less important information or technical details would be presented in smaller font size.

With saliency, important information is displayed where pension participants will most likely see it. For investments, that place would be on account statements. However, rarely is fee information presented on account statements. Fee information is generally not presented in a prospectus until page 10 or higher, and in some prospectuses containing multiple funds, fee information may not appear until page 30 or higher. In at least one prospectus, the section on fees is presented in a smaller font size than the entire rest of the prospectus.

Empirical Research Related to Fee Disclosure

Empirical research has indicated that people generally have a low level of knowledge about financial issues (Lusardi and Mitchell 2006). In particular, survey research indicates that pension participants generally do not know how much they are paying in fees (Turner and Korczyk 2005).

Survey evidence indicates that financial terminology, such as ‘expense ratio,” and simple financial mathematics are confusing to many people (Muller and Turner 2008). A survey of mutual fund investors indicates that most find prospectuses and annual statements to be too long and complex, and thus they do not read them (Investment Company Institute 2006). In the survey, 59 per cent said that prospectuses were very difficult or somewhat difficult to understand. Only 34 per cent indicated they consulted a prospectus before purchasing a mutual fund.

People tend to devote more effort to learning about financial issues when they have more money at stake. Olsberg (2002) finds that "…due to low levels of discretionary disposable income, [women feel that] spending time on retirement planning was neither rational nor productive." In contrast, she reports, both women and men with higher incomes and assets are knowledgeable savers and investors. The rational consumer will spend time on those financial decisions where the most is at stake, and for some, that might not be his/her mutual fund account. Even so, however, improved financial disclosures and the likely resulting competitive pressures could still benefit the uninvolved consumer.

When workers choose the funds in their investment portfolio, the choice of actively managed equity funds, which have higher expense ratios than passively managed funds, appears to be affected by the number of investment options offered, which is an aspect of framing. Workers tend to invest a higher percentage of the portfolio in actively managed funds the larger the number of those funds that are available (Brown, Liang, and Weisbenner 2007).

An analysis of Chile's pension system (Reyes and Castro 2007) suggests that at least in that country workers have a low price elasticity of demand for mutual fund products. This finding implies that a fund that wished to compete by lowering its fees would not attract a substantial number of new customers, thus limiting the competitive motivation to lower price.

Price elasticity may be low because many pension participants do not understand the importance of fees. Choi et al. (2006) find in an experiment that over 95 per cent of participants who were given four index fund prospectuses failed to pick the lowest fee fund, and on average picked funds only slightly lower than the average fee. For a different group, who were given a fee summary sheet that increased the saliency of the fee information, the average fee paid declined, but still over 80 per cent failed to pick the lowest fee fund. The participants in the experiment were MBA students at Wharton and students at Harvard. The experimenters conclude that many people do not realize that fees are important to consider when making mutual fund decisions. Even participants in the experiment who ranked fees as an important consideration generally failed to accurately identify the fee information in the prospectus.

Because many people do not understand the large impact of fees on account balances for accounts held many years, financial education on fees is needed in conjunction with improved fee disclosure. The economic literature on the effects of financial education indicates some success in affecting participant behavior by providing pension participants with more information about their investments. Clark et al. (2004) examine how worker participation in financial education seminars affects their retirement savings decisions. Individuals reported that they planned to change their retirement saving behavior based on knowledge gained at the seminar. Women were much more likely to alter their retirement goals and saving behavior. Lusardi (2004) finds that financial seminars positively affect participants' decision-making, particularly for participants with less education.

A survey by the Employee Benefit Research Institute (EBRI 2002) finds that 41 per cent of workers recalled having attended a seminar or receiving educational material, but nearly three-fourths of those (72 per cent) indicated that they had not made any changes as a result. However, Saliterman and Sheckley (2004) suggest that if information is provided to participants taking into account active learning principles of adult learning, investment education can be effective, causing participants to change their behavior.

An international study examines whether better legal protection for investors raises or lowers fees (Khorma et al. 2006). It does not focus specifically on disclosure. It finds that better legal protection leads to lower fees, which suggests that better disclosure of information may lead to lower fees. In that study, investor protection is measured by whether regulatory approval is required to start a mutual fund and whether regulatory approval is required to issue a prospectus.

Costs and Benefits of Enhanced Fee Disclosure

To evaluate whether requiring enhanced fee disclosure is warranted, the costs of such disclosure need to be compared to the benefits.

Costs

Enhanced fee disclosure would increase the costs of administering defined contribution pension plans, which could be an argument against enhanced disclosure. Some start-up costs for new disclosure requirements would be required for computer programming to calculate the required information. In addition, on-going costs would result from preparing account statements providing greater disclosure. However, while the presumption is that the costs borne by employees would rise, closer inspection indicates that may not be the case.

Mutual funds typically calculate daily the fees they charge. The fees are levied against the entire mutual fund rather than against each account individually. After the fee is charged against the fund, the net asset price for the fund is determined. The net asset price multiplied by the number of shares in each individual's account then determines the value of the individual's account. Thus, while fees are charged against each person's account, the process by which that is done does not lead to a record of the amount charged against each individual account. To produce that record would require a start-up expense for additional computer programming. Assuming the disclosure was added to already existing disclosure documents, there would be a small ongoing cost of the added disclosure.

A study by the U.S. General Accounting Office (GAO)[2] examines the increase in fees with improved disclosure. It finds that while the total cost to the U.S. mutual fund industry of providing specific dollar fee disclosures might be significant, the cost per investor could make such disclosure feasible (GAO 2004). The GAO finds that disclosures in dollars paid by the individual investor as charged through expense ratios

[2] Currently called the U.S. Government Accountability Office.

would add $1.07 in ongoing costs to the $184 in operating expense fees the average account is charged annually. If passed on to participants, the costs of improved disclosure would add six-tenths of 1 per cent to the operating fees charged each account.[3] Thus, the GAO study suggests that improved disclosure would not noticeably raise costs. The GAO study did not consider the costs of reporting to participants transactions costs in buying and selling securities.

Starting in 2005, Janus mutual funds in the United States began disclosing on account statements the approximate fees in dollars paid by individual investors as charged by the expense ratio. This change in disclosure was made due to a legal settlement. Janus did not raise its fees to cover the costs of disclosure. Janus does not report this aspect of fees separately, so its added costs are not disclosed. Total operating expenses for the Janus funds as a percentage of assets, which includes the cost of this disclosure, have generally declined since 2005. Thus, there is no evidence that the enhanced disclosure has raised costs borne by investors.

The experience in Australia and Sweden provides further evidence against cost as a deterrent to expanded disclosure. Those countries provide participants greater individualized fee disclosure, but costs of that disclosure have not been an issue.

The cost to participants with increased fee disclosure might be reduced below the increased costs to mutual funds for two reasons. First, with greater information about fees, participants may tend to choose lower fee providers. Second, greater competition based on participants being better informed and seeking lower fee providers may force fund providers to lower their fees in an attempt to retain and attract customers. Thus, it appears likely that greater fee disclosure at most would cause a minimal increase in expenses, but it may not result in higher costs for participants, and may even lead to participants paying lower fees.

Benefits

Generally, when consumers do not know the costs of different options, they tend to over-consume expensive items and under-consume inexpensive ones. With better fee disclosure, pension participants would be better able to decide whether those fees were justified or whether they would prefer to use lower-fee providers. Better fee disclosure is a necessary condition for participants to make better financial decisions.

Markets do not provide a competitive price when consumers do not understand the costs and have difficulty comparing across products. Because workers typically do not know how much they are paying in fees, they are unable to make informed choices in managing their retirement income, resulting in a lack of competitive pressure on fees. The excess fees paid by workers, compared to what they would be charged in a more competitive market with better informed participants, is subtracted from retirement savings and is permanently lost from the retirement income system.

[3] Since these calculations were based on the number of accounts, they do not represent the added costs to holders of more than one account.

Goals and Principles of Enhanced Fee Disclosure

The first step toward establishing minimum standards for fee disclosure is to establish the goals and principles for fee disclosure. The goals of fee disclosure indicate what the fee disclosure is attempting to achieve and why. The principles of fee disclosure indicate criteria for judging fee disclosure to assure that the goals are met. The proposal for fee disclosure in the next section attempts to meet the goals of fee disclosure by satisfying the criteria specified in the principles.

Goals

The primary goal of fee disclosure is that participants are able to make timely, informed choices. The reason for that goal is to enable participants to responsibly manage their financial resources. The list of goals elaborates on the primary goal. Aspects of that goal include:

1. The disclosure should indicate the total amount paid by the individual or the individual's account.

2. Fee disclosure should be comprehensible, predictable in form and content, in plain language, and easy to understand.

3. Participants should be able to compare "price" across different types of investments.

4. Fee disclosure should be timely, allowing workers to consider fees when deciding their investments.

5. For services where participants might reasonably want to choose between options, fee disclosure should inform the participant as to what is purchased by the fee paid.

6. Fee disclosure should not be overly expensive to provide to participants, compared to the benefits of disclosure.

Principles

The principles set out criteria for judging fee disclosure to assess how well different formats meet the goals. The principles are more detailed than the goals and relate to issues to be addressed when designing fee disclosures. The principles can be used for designing proposals for fee disclosure.

Principles of effective fee disclosure have been proposed by regulatory organizations and by previous studies. The Collective Investments Scheme Principles that have been promulgated by the International Organisation of Securities Commissions require full, accurate and timely disclosure to investors for them to make informed investment decisions. The disclosure must be clear, comprehensible, consistent and not misleading (International Organisation of Securities Commissions 1997).

The Ramsay (2002) report is a major study of fee disclosure issues that was conducted before the passage of Australian legislation requiring disclosure of administrative fees in dollars. It states that disclosure should be timely, relevant and complete; promote product understanding; promote comparison of products; highlight important information; and have regard to consumers' needs. Those principles have been adopted by the Australian Securities Investment Commission (ASIC 2007). ASIC states that an example of a disclosure issue that may benefit from clarification, particularly if greater comparability of products is to be achieved, is standardized descriptions of like fees.

The U.K. Department for Work and Pensions (2006) has stated that fee payment mechanisms should be simple and easy to understand.

The Joint Forum of Financial Market Regulators (2004) in Canada has stated that information that the plan sponsor provides to participants should be written using plain language and in a format that assists in readability and comprehension. It has issued guidelines for fee disclosure to pension participants where the plan offers participants two or more investment options. The guidelines supplement legal requirements. These guidelines reflect regulators' expectations regarding defined contribution plans' operations, regardless of the regulatory regime applicable to the plan. While the guidelines lack formal legal status, it is expected that courts will give them considerable weight (Cohen and Fitzgerald 2007). The guidelines are designed to ensure that plan participants receive the information and assistance they need to make investment decisions. The guidelines also set out certain responsibilities of plan sponsors in choosing service providers and investment options, including the reasonableness of the fees charged.

The Joint Forum of Financial Market Regulators (2004) provides the following guidelines concerning fee disclosure. The plan sponsor should provide participants the description and amount of all fees, expenses and penalties relating to the plan that are borne by participants, including:

- any costs that must be paid when investments are bought or sold;
- costs associated with accessing or using any of the investment information, decision-making tools or investment advice provided by the plan sponsor;
- investment fund management fees;
- investment fund operating expenses;
- record keeping fees;
- any costs for transferring among investment options (including penalties, book and market value adjustments, tax consequences);
- account fees; and,
- fees for services provided by service providers.

Some of these fees, such as record keeping fees and fees of other service providers, relate to operating decisions made by plan sponsors and should be disaggregated when disclosed to plan sponsors. They could be aggregated when disclosed to plan participants, with disaggregated information available upon request.

The guidelines do not require that fee information be provided in recurring communications to participants, such as statements of account activity. The guidelines indicate that statements of account activity must be provided at least annually. Those statements need to indicate how the participant could obtain additional information concerning fees paid.

The investment management fees are usually expressed as a percentage of a fund's net asset value. That information is disclosed in the prospectus for mutual funds but is generally not disclosed on quarterly and annual plan account statements that individual pension participants receive.

In 2008, the Joint Forum of Financial Market Regulators proposed that investors be provided before they purchase a mutual fund a two-page document called Fund Facts. Because many investors find mutual fund prospectuses too long and complicated, Fund Facts would provide the most important information, including information about fees, in a readily accessible format. These would be written using the following principles:

- avoid legal or financial jargon
- sue simple examples, tables and graphics to illustrate concepts
- use bold headings and white space to make the document easier to read
- write at a grade level of 6 or less

With the distribution of Fund Facts, mutual fund prospectuses would no longer need to be delivered, presumably reducing the costs of disclosure.

In July 2008, the Employee Benefits Security Administration of the U.S. Department of Labor proposed rules for fee disclosure to pension participants in individual account plans where participants have choice as to investment options. General plan-related information concerning fees must be provided to the participant before becoming eligible to join the plan, and at least annually thereafter. Every quarter the plan must provide the participant information measured in dollars paid by the participant concerning administrative fees and fees for special services, such as requesting a plan loan. Information on investment related expenses must be provided before the participant enrolls in the plan and annually thereafter. This information does not need to be presented in dollars paid by the participant.[4]

[4] See Pension Rights Center (2008) for a more detailed summary.

Proposed Principles

Taking into account the principles proposed elsewhere, this report proposes the following principles:

1. The disclosure format and the information provided should be understandable by a target audience with a low level of financial sophistication.
2. The disclosure should be clear. It should not be misleading. It should be written in plain language without jargon. It should state that the fees are paid by the participant. It should explain any terms that might not be known by participants. An example of misleading disclosure is to disclose that there is a zero charge for something, when the charge is bundled with other charges.
3. The disclosure should provide the full amount of fees paid by the participant. Thus, the disclosure should include fees associated with transactions, rather than having those fees included in the net price of assets bought and sold.
4. The disclosure should promote comparisons across investment options. Thus, terminology and formats should be standardized across financial products.
5. The disclosure should facilitate comparison across investments of different amounts. Thus, it should include both dollar amounts and amounts as a percentage of assets.
6. Disclosures should be divided into two categories: disclosures that are required and disclosures that are available on request.
7. Flat dollar fees, such as a fee of $20 per year per investment or per participant, should be disclosed separately as flat dollar amounts, and should be included in the total.
8. Fee information should be disclosed in a prominent location. It should be disclosed in the first few pages of the primary document in which it is disclosed. In some cases, this may mean that it should be disclosed in a separate document. Fee information should not be information that participants have to look for.
9. All fee information should be disclosed in a single document and in a single place in the document. The disclosure should be in a document that participants are likely to read.
10. The disclosure should be timely. Thus, the disclosure should be provided before an initial investment decision is made. It should also be provided when the participant may be considering making investment changes, such as when the participant is reviewing account statements. It should be provided before the participant makes an unusual transaction generating a fee, such as a hardship withdrawal or a loan.
11. The costs of disclosure should be considered. When precise fee accounting would be costly, an approximation should be used, with that clearly indicated.
12. The disclosure should indicate activities by the participant that generated fees. Thus, if fees are charged for loans, for advice, for excessive trading, or for obtaining documents, that should be disclosed, and it should be disclosed before the activity is undertaken as well as with quarterly and annual disclosures.
13. Fees should be aggregated into major categories to avoid information overload that would result from excessive detail. However, some disaggregation should

be provided. At a minimum, administrative expenses should be reported separately from investment expenses when they are charged separately.

14. To assist participants in interpreting fee information, some supporting information and an example of the importance of fees should be provided.

Administrative Issues in Fee Disclosure

In developing a proposal for minimum fee disclosure, several other specific issues need to be addressed.

Where and When Should Fee Information Be Disclosed?

Information about fees is most useful if it is disclosed in a document and a location in the document that participants are likely to read. It also needs to be disclosed at a time relative to decision making when participants are likely to find it useful.

Fee information should be disclosed when participants make their initial investment decisions. Providing that information after they have decided what to invest in would prevent them from making an informed decision. For pension plans, this requirement should not be overly burdensome because basic information about the investment options already is provided when participants are considering their investment options. It should not result in delays since that information would be provided along with other information already provided at that time. It would not add to the regulatory burden because that information is already available.

Fee information also needs to be disclosed along with regular quarterly and annual disclosures. As participants' account balances grow, and as they gain greater financial sophistication with investment experience, they are able to re-evaluate their initial decisions. Thus, it should be disclosed with participants' account statements because participants may be considering making changes in their investments when they are reviewing their account statements.

How Should Fee Information Be Disclosed?

Fees can be disclosed as a percentage of assets. Alternatively, they can be disclosed in dollars paid by the participant. Issues concerning the choice between these two formats include the costs of obtaining the information for both approaches and which approach provides the more useful information for participants. Ultimately, disclosing fees in both formats may be the best approach for participants (Muller and Turner 2008). A survey of 401(k) participants in the United States finds that 73 per cent prefer fees to be disclosed in both dollars and as a per cent, 22 per cent favor dollars only, and 4 per cent favor per cent only (AARP 2008).

When fees are disclosed as a percentage of assets, participants may not understand the importance of what appear to be small differences. For example, the difference between expense ratios of 0.2 per cent and 0.7 per cent may appear to be small because both numbers are small in most contexts that people encounter. Thus, participants may misperceive the importance of differences in fees when they are expressed in per cents.

Fees could be disclosed as the exact or approximate amount paid in dollars (or currency units) by an individual. Alternatively, they could be disclosed as the fees that would be paid on a hypothetical account with a balance of $1,000 at the start of the period and with no purchases or withdrawals during the period. There is a tradeoff between providing personalized information and the added cost of such disclosure. If the cost of providing personalized information were deemed to be too high, fee information could be disclosed for a portfolio of $1,000.

For fee disclosure to be useful, participants need information to help them evaluate the fees they are paying. For example, that information could include a table showing by how much the fees they are paying would reduce the account balance in a standardized account held to age 62.

Aggregation of Fee Information

An issue concerning fee disclosure is how much detail about fees would be useful for participants to receive. Plan sponsors need to receive detailed cost information to carry out their fiduciary duty of evaluating the reasonableness of fees and evaluating whether recipients of fees may be affected by conflicts of interest. Participants, however, need less detail to make informed decisions. Participants could be overwhelmed by detail and consequently need to receive the information at a more aggregated level. The question then arises as to the level of aggregation that should be used in providing fee information to participants. The most aggregated level would be to provide a single figure reporting total fees paid by the participant.

Participants would not be expected to judge the reasonableness of the price of many of the administrative services provided, which would be the responsibility of the plan sponsor. Also, employers may pay for some administrative fees, with no charge, directly or indirectly, against participants' accounts. While employers may wish to disclose that they are doing that to demonstrate their commitment to their employees, such disclosures do not affect employee understanding as to the fees that they are paying.

Proposed 2008 legislation in the United States, the 401(k) Fair Disclosure for Retirement Security Act, would mandate fees charged by mutual funds to be disaggregated into four categories: investment management fees, transaction fees, administrative and record keeping fees, and other fees as specified by the Secretary of the U.S. Department of Labor (Boles 2008).

Several reasons support the idea of disclosing separately fees for administration and fees for investment management. First, they are different functions. Second, the separate disclosure of both administration and investment fees enables investors to compare how efficient each of these aspects is across a variety of financial products. Third, it is typically the case that investment management fees are the largest ongoing fees. It is important that the fee which is most directly related to the performance of the fund be separately disclosed (Ramsay 2002).

Comparing Fees Across Providers

A further issue is whether benchmarking information should be provided that would allow pension participants to compare the fees they pay with fees on alternative investments. An issue arises as to exactly what the comparable benchmark would be, especially when mutual funds differ in the services they provide. For example, some provide monthly account statements, while others provide quarterly account statements and some pension funds may only provide annual statements.

Comparisons across providers can be difficult if providers have different fee structures. For example, if one provider only charges a percentage fee but another also charges a flat fee, the lower cost provider could depend on how much the participant contributed.

Notwithstanding these problems, comparative fee information would be useful for participants to have (Consumer Federation of America 2008). This could be provided as an average fee for a particular type of investment or as a range of fees. Further work needs to be done to determine the appropriate benchmarks for comparison.

It could be argued, however, that participants only need information relative to the choice that they are offered. The plan sponsor needs to consider the fees charged by the plan options it selects relative to the broader range of mutual funds and investment options. Activist, sophisticated participants can still pressure plan sponsors to offer low fee options by presenting information readily available to them as to alternatives with lower costs.

A Proposal for Minimum Fee Disclosure Requirements

Based on the discussion as to desirable features of fee disclosure, a proposal for minimum fee disclosure is now presented. While this disclosure proposal is well-suited to mutual funds, further consideration needs to be given as to the appropriate disclosure for annuity products and some other investment products in which pension participants invest. In addition to this disclosure, mutual funds should be required to provide a prospectus before the participant makes his or her initial selection.

What Fee Information Should be Disclosed?

1. When the participant is making his or her initial choices after enrolling in a pension plan, fees should be disclosed for the investment choices in a standardized table, showing both the expense ratio and fees paid per $1,000 per year, assuming a standard rate of return. The table should also indicate additional expenses that the participant will or might incur, such as minimum account balance charges (Consumer Federation of America 2008). This disclosure should be available in print form for persons preferring

that format, but service providers should also be able to provide it over the internet, which is more cost effective, for persons preferring that format.

2. The disclosure for fees paid by the participant should contain four items plus a total. The items, all measured as the amount paid by the participant, are: 1) investment and administrative expenses as contained in the expense ratio, 2) transactions costs of buying and selling, 3) other expenses charged to all participants, which may include plan administrative expenses, and 4) fees charged due to actions taken by the participant (loans, special advisory services received).

3. Other expenses should be itemized if they include fees for activities within a particular set of activities that are not generally engaged in, or they include flat fees. This could include fees for receiving a loan from the plan, or fees for splitting the assets at divorce. Fees for a specific non-recurring service should be disclosed before the participant commits to that service.

4. Fees should be disclosed in dollars per quarter on quarterly statements and in dollars per year on annual statements. In addition, they should be disclosed as a per cent of assets. When it is not feasible to determine the exact amounts paid by the participant, approximate amounts should be disclosed, indicating that they are approximate amounts, and indicating the range in which the actual amount would likely fall.

5. Some educational information should be provided. This should include an example indicating the effect of higher fees on account balances at retirement. This could be provided through a standard disclosure with a worked example.

6. Participants should have the option to request more detailed information about fees. More detailed information could provide greater disaggregation of fees.

When Should it be Disclosed?

7. The disclosure should be provided to the participant before making the first investment in an asset. Disclosures should also be provided every time the participant receives an account balance and transactions statement, in which case it should be provided using the information relevant to the participant's own account. In addition, it should be disclosed at least thirty days before any change in fees occurs.

Where Should it be Disclosed?

8. Fees should be disclosed for an investment of a standard amount, such as $1,000, in the prospectus within the first few pages. It also should be disclosed on quarterly and annual account statements. It should be disclosed on the first or second page of the quarterly and annual disclosure document. The disclosure should be in standard font size.

How Should it be Disclosed?

9. The information should be disclosed in plain English. The disclosure should clearly state that these are expenses borne by the participant as charged against the participant's account.

A Prototype Fee Disclosure

Based on the proposal for fee disclosure, a prototype fee disclosure is now developed. The fee disclosure has four parts. First, fees are disclosed at the time the worker enrolls in the plan, when the participant is considering what investments to make. Second, that same, or similar, information should be provided anytime fees are changed. Third, fees are disclosed quarterly and annually in a separate fee disclosure table. Fourth, fees are disclosed quarterly and annually with the disclosure of other transactions.

Tables 2 and 3 provide a prototype fee disclosure at the time of enrollment. Table 2 provides information on investment-related fees. An alternative to this single table format is that each fund provider could provide a table using the same standard format. This format presents fees as a per cent of assets and as dollars per $1,000. It presents information on the trading costs of funds, which is not included in the expense ratio. It also indicates when comparing across funds the effect of fees on account balances at the end of 10 years.

Table 2. Prototype disclosure of investment-related fees at time of enrollment in plan

	Fund A	Fund B	Fund C
Expense ratio			
Trading costs as per cent of assets			
Total annual expenses as per cent of assets			
Total expenses on an investment of $1,000			
Account balance after 10 years with $1,000 contributed at the beginning of each year and a 5% rate of return			

Note: the expense ratio is paid by you out of your account. It is the investment expenses paid by divided by you account balance.

Source: Authors' compilation.

Table 3 provides information on plan-related fees. Some of these fees may be charged to all participants, such as a flat fee for each fund in which the participant invests. Some fees may be related to particular actions taken by some participants, such as taking a loan from the plan. If a particular category of administrative fees is not charged, the plan would not need to include that type of fee in the disclosure. If no administrative fees were charged, the disclosure would indicate that administrative fees were covered by the employer or through the investment fees.

Table 3. Prototype disclosure of plan-related fees at time of enrollment	
Expense category	Fee
Fees charged all participants	
Annual fee for each mutual fund in which you have invested	$10
Other administrative fees charged all participants	Other fees are not charged separately, but are included in the investment expenses.
Fees charged participants requesting certain services	
Fee if you take a plan loan	$20
Fee if you request a division of plan assets at divorce	$20
Note: This table does not include the fees charged by each individual investment.	
Source: Author's compilation	

Because tables 2 and 3 are not individualized, they are inexpensive to provide, once they have been prepared. They should be provided annually, in addition to being provided at time of initial participation in the plan.

Table 4 presents the fee disclosure form for fees the participant paid. Key information in the disclosure is presented in bold. The disclosure facilitates comparison between the two funds in which the hypothetical participant has invested. The disclosure highlights not only the higher fees charged by an actively managed fund but also the higher trading costs. The disclosure does not provide a detailed breakdown of the fees except for the fees charged for services requested by the participant.

If a plan offers a number of funds, table 4 would possibly extend onto a number of pages. A separate version of table 4, but following the exact format, could be provided by each fund provider to a plan in plans with multiple fund providers.

Table 4. Prototype fee disclosure
Annual fee disclosure to participants of the XYZ Corporation defined contribution pension plan
This fee information is provided to you to help you make informed decisions about the investments in your defined contribution pension plan. Fees are important to consider when selecting a mutual fund or other investment because they lower your returns. However, you should also assure that your investments are adequately diversified, with some types of investments having higher fees than others.
Fees paid by you during the period January 1, 2008 to December 31, 2008
Fees paid by you either directly or as charged to your account balance

1) Administrative and investment fees charged to your pension account through the expense ratio charged by: ABC Stock Index fund DEF International Stock Actively Managed fund	 $99.21 (expense ratio* of 0.50%) $85.34 (expense ratio* of 1.25%)
2) Expenses charged to your pension account incurred in buying and selling shares by: ABC Stock Index mutual fund DEF International Stock Actively Managed mutual fund	 $21.57 $39.19
3) Other fees charged to you by the plan administrator for **services provided to all participants**. These include recordkeeping fees and the expense for educational information provided to all participants. These fees are charged on a per participant basis.	$10
4) Other fees charged to you by the plan administrator for **services you have requested**.	Plan loan initiation fee: $25 Plan loan annual fee: $20
5) TOTAL FEES PAID BY YOU	**$300.31**
If you - have any questions about these fees, - wish to obtain more detailed information about fees - wish to obtain other information about the funds you have invested in, or - wish to change your investment allocation, please contact your plan administrator at the following phone number: xxx-xxx-xxxx or visit the following web site xxx@xxx.com. Note: the expense ratio is the total fees charged to investors expressed as a per cent of the total assets in the fund.	
Source: Authors' calculations	

If administrative fees are paid for through the investment fees, the plan would not need to separate out the two types of fees.

The typical transactions disclosure that currently pension participants receive, incorporating contributions, investment earnings, and disbursements, looks something like that in table 5. Fees are not disclosed. Further, the disclosure appears to give a complete accounting of transactions because the transactions exactly account for the difference between the beginning balance and the ending balance, providing the impression that the participant paid no fees.

To clarify that the participant paid fees, the transaction disclosure should either follow the format of tables 6 or 7. In table 6, it is clearly indicated that fees are subtracted from net investment gains. In table 7, fees are listed as a separate category. Table 7 would be preferable, providing a separate accounting of fees, but if it is not feasible to provide an exact accounting of fees, that form of disclosure may not be feasible.

Table 5. Summary prototype transactions disclosure, as currently done

Annual transactions disclosure to participants of the XYZ Corporation defined contribution pension plan

Fund	Beginning balance	Employee contributions	Employer contributions	Withdrawals	Net investment gains or losses	Ending balance
ABC fund						
DEF fund						

Source: Authors' compilation

Table 6. Summary prototype transactions disclosure, with indication that fees are paid

Annual transactions disclosure to participants of the XYZ Corporation defined contribution pension plan

Fund	Beginning balance	Employee contributions	Employer contributions	Withdrawals	Net investment gains or losses, less all fees	Ending balance
ABC fund						
DEF fund						

Source: Authors' compilation

Table 7. Summary prototype transactions disclosure, with separate accounting of fees

Annual transactions disclosure to participants of the XYZ Corporation defined contribution pension plan

Fund	Beginning balance	Employee contributions	Employer contributions	Withdrawals	Net investment gains or losses	Fees	Ending balance

ABC fund							
DEF fund							
Source: Authors' compilation							

A Fee Disclosure Score Card

Based on the proposal for fee disclosure, a fee disclosure score card (table 8) is developed to rate the six countries discussed in the Appendix. Those countries are Australia, Canada, Chile, Sweden, the United Kingdom, and the United States.

In interpreting the score card, the score reflects a number of different aspects of fee disclosure, some arguably of greater importance than others. Policy analysts will differ as to their importance. As a first attempt, we have chosen an unweighted scoring, meaning that each element has equal weight.

By this score card, Sweden in its mandatory individual account systems provides the best disclosure of any national regulatory system. It discloses fees for administrative expenses and for investment expenses both as a per cent and in absolute amounts paid by participants. It, however, discloses the amount paid by each participant as the aggregate of administrative expenses and investment expenses, rather than as two separate items plus the total. Also, because of a complex rebate system, participants do not know precisely the net investment fees in percentage terms. None of the countries discloses transactions costs to participants, though that information is available for mutual funds at the fund level in the United States.

Table 8. Score Card for Fee Disclosure, Six Countries, 2008

Disclosure	**Australia**	**Canada**	**Chile**	**Sweden**	**UK**	**US**
Amount Paid						
Administrative expenses	Y	N	N	Y	N	N
Investment management	N	N	N	Y	N	N
Investment transactions	N	N	N	N	N	N
Participant-initiated transactions	NR	N	NR	NR	N	N
Per cent of Assets						
Administrative expenses	N	N	Y	Y	N	N
Investment management	Y	Y	Y	Y	Y	Y
Investment transactions	N	N	N	N	N	N
Other						
Participant education on importance of fees	Y	N	N	N	N	N
SCORE	3	1	2	4	1	1

Source: Source: Authors' calculations

Note: Y=yes, N=NO, NR=Not relevant. The score is the sum of the "yes" responses. The disclosure in Sweden refers to the mandatory individual account system. In Chile, the administrative expenses and the investment management costs are combined. Participant education refers to education or information provided in conjunction with fee disclosure.

Conclusions

The disclosure to pension participants of fees they have paid could be considerably improved by reporting fees paid on the first page of the participant's annual account statement. By contrast, in some instances disclosures are blatantly misleading, for example indicating that zero fees have been paid when in fact fees have been bundled and not charged separately for a particular activity. More often, on account statements nothing is disclosed concerning fees and the accounting of transactions linking the beginning and ending account balance implies that no fees were paid.

Several types of disclosures are not helpful Applying insights from behavioral economics, disclosures in some countries appear more like they are designed to obfuscate than they are to clearly convey information. Fee disclosures that prospectuses provide confuse people who are not financially sophisticated, which includes most pension participants.

Disclosures that are only available upon request are not helpful to most participants because few participants will go to the effort to obtain that information. Disclosures that involve jargon are not helpful because many people do not know the meaning of commonly used financial terms, such as loads or expense ratios. Presenting fees information in plain English, rather than with a heavy reliance on jargon, would help pension participants understand fees.

Standardization of types of fees and formats in which they are presented would facilitate comparisons across different investment options. Lack of standardization makes fee comparisons difficult. For example, when some funds charge fixed fees or loads as well as fees based on assets or contributions, it can be difficult to compare costs across investment alternatives.

While the cost of greater disclosure has been raised as an issue, the evidence indicates that the cost borne by participants would at most be small. There even could be a reduction in costs paid due to participants switching to lower cost funds. A study by the U.S. General Accounting Office (GAO) finds that if the cost of improving disclosure were passed on to the participant, it would add six-tenths of 1 per cent to the operating fees charged each account. (Note that this amount is not six-tenths of 1 per cent of assets but six-tenths of 1 per cent of fees).

The greater fee disclosure should be accompanied by greater information as to how to interpret the importance of fees. Many people do not understand how large an effect an apparently small difference in fees can make on account balances at retirement.

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APPENDIX: COUNTRY STUDIES

This section examines fee disclosure to pension participants in six countries, starting with the United States, for which the most detail is provided. Table A1 (end of paper) provides a summary of the level of fees charged by mutual funds in these countries, excluding Chile, for which comparable information is not available. While the unique aspects of fee disclosure in each country are highlighted, some issues that are common to all countries are not repeated for each country.

UNITED STATES

Background

Traditionally, occupational pensions in the United States were predominantly defined benefit plans. However, over at least the past three decades for which good data are available, defined benefit plans have declined and defined contribution plans have grown. The 401(k) plan, a defined contribution plan that generally requires worker contributions for worker participation, is now the plan type having the most active participants.

In the United States, a national policy discussion is taking place concerning the level and disclosure of fees to pension participants and plan sponsors. The topic is the subject of more than a dozen court cases against some of the largest companies in the country, as well as Congressional hearings, and possible legislation. The Employee Benefits Security Administration of the U.S. Department of Labor (DOL) is undertaking three regulatory projects concerning fee disclosure to participants, plan sponsors, and to the Department. The U.S. Securities and Exchange Commission (SEC) is considering changes in the ways that fees are disclosed.

While administrative and investment expenses are borne by defined benefit plan sponsors, both expenses generally are borne by participants in defined contribution plans. Employers can and do charge participants for their own expenses in managing the plans, as well as the costs for hiring outside service providers.

Regulatory Framework

The federal government regulates private sector pension plans. Federal law pre-empts state law concerning pension regulation. Most of the regulatory authority over defined contribution plans is split between the Internal Revenue Service (IRS), which is the tax collection agency within the Treasury Department, and the Employee Benefits Security Administration (EBSA), which is an agency within the Department of Labor. In part, this division of authority exists because U.S. pension policy has long reflected the tension between balancing tax and other incentives for employer sponsorship of pension plans with provisions that protect employees from malfeasance and unfairness. The IRS has responsibility for funding, eligibility to participate in plans, and ensuring entitlement to plan funds.

The DOL has authority over fiduciary issues, proper disclosure, and claims procedures, and has primary authority concerning the fees issues for pension participants. The United States thus relies on a workplace regulator rather than a financial services regulator as its primary entity for regulating pensions (Muir 2007).

The Securities and Exchange Commission (SEC) regulates the disclosure of fees in mutual funds. It does not regulate the level of fees, but leaves fee setting to competitive forces in the financial markets. According to its documents, it attempts to protect investors against inflated fees by two approaches. First, it attempts to prevent conflicts of interest that would cause inflated fees. As part of that approach, mutual funds are required to have a certain number of independent directors, who are supposed to act to assure that fees charged are reasonable. Second, it attempts to insure that competitive forces function effectively by assuring that fees are disclosed in a useful manner (US SEC 2000). An issue in regulating fee disclosure relating to investment expenses is whether pension participants are adequately protected through the regulations provided for mutual funds, or whether they need additional or different disclosures from those provided to other investors.

The Financial Industry Regulatory Authority (FINRA), which has replaced the National Association of Securities Dealers (NASD), is the private sector regulatory organization responsible for regulating brokerage firms. On its website, it provides a mutual funds expense analyzer.

While pensions generally are regulated at the federal level, insurance products purchased by pension participants as investments are regulated by state governments, similar to pension plan regulation in Canada.

Level of Fees

Because of the lack of adequate disclosure, no solid evidence exists as to the level of fees paid across a large number of plans. However, it appears that for plans with less than 100 participants, fees can be as high as 3 per cent of assets per year, and for plans of large employers with several hundred or more employees fees can be 2 or higher per year (Preston and Matsumoto 2008). However, retail clients can purchase equity index mutual funds from Vanguard with expense ratios of less than 0.2 per cent (20 basis points).

A survey indicated that 37 per cent of U.S. plan sponsors pay all administrative and record keeping expenses (Table A2). Those fees do not include the fees for management of investments through mutual funds. To understand trends in mutual fund fees, the Investment Company Institute (ICI) has combined major fund fees in a single measure. ICI created such a measure by adding a fund's annual expense ratio to an estimate of the annualized cost that investors pay for one-time sales loads. By this measure, mutual fund fees that investors pay have trended downward since 1980. In 1980, investors in stock funds, on average, paid fees of 2.32 per cent of fund assets. By 2006, that figure had fallen to 1.07 per cent of fund assets. Fees paid on bond funds have declined by a similar amount (ICI 2007).

Regulation of Level of Fees

While the Department of Labor regulates to some extent fee disclosure to pension participants, it does not regulate the level of fees, except for a general fiduciary regulation that plan sponsors have the duty to assure that the fees are reasonable. Thus plan sponsors need detailed disclosures from service providers to assess the reasonableness of the fees charged for specific services, and whether the service provider has a material conflict of interest or receives additional compensation from third parties in connection with the plan's business (Campbell 2008).

Pension participants have sued plan sponsors for permitting excessive fees to be charged to participants. In 2006, a number of lawsuits were filed alleging that 401(k) plan fees at some large companies violate ERISA's fiduciary requirements. The suits generally are against the plan sponsor because of the sponsor's fiduciary responsibility, rather than against the pension service provider, though some suits have been against both sponsor and service provider. The suits allege that making proper disclosures of fees is insufficient to meet the plan sponsor's fiduciary duty. The plan sponsor has an added duty of assuring that the fees are reasonable.

Regulation of Types of Fees

The Department of Labor has a broad fiduciary regulation requiring that the types of fees must be justified by a need for the service provided. In addition, a Department of Labor ruling permits certain fees to be charged to individual accounts based on services provided to a participant that generate costs, such as requesting a benefit payment (Huss 2003). Thus, fees for particular actions, such as benefit payment or receipt of a loan, may be charged and disclosed to participants.

The Department of Labor has stated that plan sponsors have considerable latitude in determining how plan expenses will be allocated among plan participants and beneficiaries (US Department of Labor 2003). For example plan sponsors can determine whether some fees are charged on a per capita basis, a pro rata (per cent of assets) basis, or on a utilization basis. For example, some defined contribution plans may charge participants for calculating the benefits payable under the different distribution options available, such as joint and survivor annuity, lump sum, or single life annuity.

The Department of Labor has indicated that certain fees cannot be charged to the plan and its participants but must be borne by the plan sponsor. These fees are called "settlor" fees. Settlor fees relate to the formation, rather than the management, of plans, including decisions relating to establishing, designing and terminating plans. These expenses would not be reasonable expenses of a plan and its participants because they would be incurred for the benefit of the employer (US Department of Labor 2001).

Regulation of Fee Disclosure

Fee Reporting Under DOL Requirements

The Department of Labor requires plan sponsors to report plan fee information on four forms: the Form 5500, the Summary Annual Report, the Summary Plan Description, and the Summary of Material Modifications. In 2007, the Department of Labor published a regulation changing the Form 5500 Annual Report filed by plan sponsors to improve the disclosure of plan-related fees by plan sponsors to the government. This report is filed by plan sponsors with the Department of Labor.

The Form 5500 is filed annually with the Department of Labor by all private sector pension plans with 100 or more participants. Smaller plans have reduced filing requirements. This schedule was revised for plan years beginning after December 31, 2008 providing more information about direct and indirect payments of fees.

Participants do not receive the Form 5500 unless they request it, which rarely is done. That information provides total fees paid by the plan, and thus it is not useful for participants for determining how much of those fees were charged to their accounts. The Summary Annual Report (SAR) for the plan, which is provided to plan participants annually, also provides information on total fees paid by the plan, but does not provide an individualized statement.

The Summary Plan Description (SPD) provides general information about fees. The Department of Labor requires that any plan provisions that may result in a fee being charged to a participant must be disclosed in the Summary Plan Description. This document must be given to all new plan participants and must be made available to other participants on request. Examination of the SPD for one plan indicated that administrative fees were not charged to the plan and participants, but further examination of the Form 5500 for that plan indicated that in fact those fees were charged to the plan and participants.

In addition to the information required on the Form 5500, the Department of Labor (DOL) has released guidance as to what information it requires 401(k) plan sponsors to provide to plan participants. Plan sponsors need to provide a quarterly report concerning the individual's account. The report is required to provide a statement concerning the desirability of holding a diversified portfolio and of not holding too much of the portfolio in employer stock. However, the DOL does not require that any information concerning plan fees be provided in these reports.

In addition, plan participants must receive a Summary of Material Modifications whenever a change in the plan provisions with respect to fees, or other major changes in the plan, are made.

In 2008, the Department of Labor proposed major new regulations on fee disclosure to pension participants by employers providing participant-directed individual accounts. Employer practices differ considerably (Table A3), with some providing little or no information to participants. The principle motivating the proposed regulations is that plan sponsors have a fiduciary responsibility to provide participants sufficient information about their investment options for them to make informed decisions. The required disclosures must be provided to participants when they enroll in the plan and at least annually thereafter. The disclosure must provide information about administrative fees charged to the plan's assets that are not otherwise included in investment-related fees. It must state whether the fees are charged based on assets in the participant's account or on a per person basis. These fees must be disclosed quarterly as dollars charged to the participant's account. This requirement will have little effect because most plans include administrative fees with investment-related fees.

In addition, individual expenses charged for services provided to the individual must be disclosed in dollars. Examples include for a plan loan or for advice that is provided for a fee. These expenses must be reported quarterly. Again, this requirement will have little effect since in most quarters most participants do not incur individual expenses.

Information on investment-related fees must be disclosed to the participant before enrollment in the plan and at least annually. That information includes the expense ratio of the plan, but not the actual dollar expenses. The fee information must include information on shareholder-type fees, which includes sales fees and redemption fees. It must also include a statement that fees are only one of a number of factors that should be considered in making an investment decision.

A comparative chart indicating benchmark rate of return information must be provided, but no similar comparison of fees is required. Plan sponsors would only be required to provide an investment prospectus on request.

The ultimate resolution of this proposal is unknown as of August 2008, but it should be noted that fee disclosure legislation has also been proposed in Congress. In 2008, proposed legislation, the 401(k) Fair Disclosure for Retirement Security Act, approved by a Committee of the House of Representatives, if passed would mandate fees charged by mutual funds to be disaggregated into four categories: administrative fees, investment management fees, transaction fees, and other fees (Boles 2008). In addition, a new Presidential Administration may modify the DOL proposal.

Fee Reporting Under SEC Requirements

About half of 401(k) plan assets are invested in mutual funds (Investment Company Institute 2006). The Securities and Exchange Commission (SEC) regulates mutual funds and prescribes what fees borne by investors must be disclosed and in what format. The SEC and the Department of Labor to some extent coordinate regulatory efforts. They also coordinate enforcement efforts in some areas. They have been holding meetings on related fee disclosure efforts to coordinate the changes to mutual fund disclosures made by the SEC and changes to pension disclosures made by DOL (Campbell 2008).

By law, mutual funds are required to disclose fees measured as an expense ratio in a standardized fee table near the front of the prospectus. In practice, that may be disclosed on page 30 or later if a number of different funds are described in the same prospectus.

That information must be disclosed in semiannual and annual reports of the funds, but not in the account statements received by participants. Mutual funds generally do not disclose information about fees in the account statements that individual pension participants receive.

Fees are disclosed as an expense ratio, though that term often is not used. The expense ratio is the ratio of annual expenses divided by average net assets. However, mutual funds are not required, and consequently do not, disclose all the fees that are charged to individual accounts. The expense ratio does not include sales charges (loads), the costs arising due to the bid – ask spread in capital market transactions, transactions fees, early redemption fees, and performance-based fees.

The mutual fund registration form submitted to the Securities and Exchange Commission divides total expenses reported in the expense ratio into three categories: management fees, rule 12b-1 fees, and other expenses. The prospectus provides information on these three categories of fees plus the total of the three. Management fees include investment advisory fees and administrative or other fees paid to the investment adviser for services. Rule 12b-1 fees are fees a fund may charge to cover the marketing expenses of the fund. These fees are ongoing fees and can be larger than the management fee. They are paid to brokers who market the fund. Typical "other expenses" include payments to transfer agents, securities custodians, providers of shareholder accounting services, attorneys, auditors, and fund independent directors (US SEC 2000).

The expense ratio is debited from shareholders' assets. Pension participants may be charged the retail expense ratio that is charged to retail clients, or they may be charged a lower institutional rate.

In 2004, the SEC added two requirements concerning fee disclosure. First, in shareholder reports, but not quarterly account statements, the actual fees charged must be disclosed for a hypothetical investment of $1,000 with the actual rate of return earned by the fund. For example, it might report that $5.27 in expenses had been incurred for an investment of $1,000. This information falls short of disclosing the amount of fees the individual pension participant paid over the reporting period, but allows pension participants to estimate this amount. Second, to facilitate comparison with other funds, all funds are required to disclose the fees they would have charged had they earned a rate of return of 5 per cent (SEC 2004). The SEC argues that these disclosures balance the needs of investors for information with the costs of providing the information on an individualized basis. However, these disclosure requirements could be further expanded to apply also to quarterly and annual reports that participants receive on their accounts.

Reporting Brokerage Commissions

Some mutual fund brokerage commission information is disclosed in a fund's *Statement of Additional Information* (SAI). The SAI is filed with the Securities and Exchange Commission and is not automatically or routinely provided to pension participants and other investors. Most participants presumably do not know about the existence of this information. It is available on request and some mutual fund companies make it available over the Internet. SAI disclosures differ both across fund families[5] and within a fund family (Table A4). The investor thus has little opportunity to compare these costs among available fund products. Standardizing reporting requirements would make it more possible for participants and plan sponsors to compare investment products.

Fee Disclosure

401(k) plan fees and the ways they are charged have become complex. The complexity of fee structures can make it difficult for participants and plan sponsors to understand and compare fees. The U.S. Department of Labor (DOL) 401(k) Plan Fee Worksheet lists 38 definitions concerning fees and 36 separate types of fees that plans may incur and should consider in their fiduciary decisions concerning the choice of plan service providers (www.dol.gov/ebsa/pdf/401kfefm.pdf).

Even plan sponsors may not know how much in fees their participants are being charged for particular services by record keepers, investment managers, and other service providers. This situation arises because plan sponsors have consistently favored the imbedded and invisible mutual fund pricing model, rather than explicitly paying for custodial, record keeping, and other services.

Financial service providers have developed several institutional arrangements for providing services to pension plans and charging fees. These include revenue sharing and "soft dollars."

Revenue Sharing and "Soft Dollars"

Revenue sharing is a common practice where fees collected by mutual fund managers often pay several other pension plan service providers. Mutual funds generally pay the 401(k) plan record keepers through revenue sharing for this subcontracting relationship. Revenue sharing makes it difficult to determine the amount being paid for different services. Low-cost funds, however, seldom offer revenue sharing arrangements (Rubenstein and Marzinsky 2007). With revenue sharing arrangements, record keeping costs that might otherwise be paid by the plan sponsor are paid out of the fees charged participants. Revenue sharing arrangements include transfer agent fees and 12b-1 fees. Transfer agent fees are paid to the record keeper when the record keeper is not affiliated with the mutual fund in which the plan is invested.

Trust companies, banks, and mutual fund companies acting as fund transfer agents often subcontract with other companies to track buy and sell orders and credit them to the appropriate participant accounts. These companies are called sub-transfer agents, and they are compensated by investment companies through revenue sharing payments called sub-transfer agent fees. Sub-transfer agent fees are paid to third-party service providers

[5] The reference to a fund family can mean different things in different contexts. Some mutual fund companies refer to groups of similar funds as "families." In this paper, "family" will refer to all the funds offered by a particular fund company.

for services such as record keeping or communications. Until recently, these fees have not been reported to the Department of Labor on the Form 5500, which is the primary way that plan fees are disclosed to the government (US DOL 2004b).

Many service providers do not disclose information about revenue sharing arrangements. The information they provide participants often is not easily understandable. Many providers indicate that some services they provide are “free,” which means that participants are not charged for them separately rather than meaning that participants do not bear their cost.

While bundled services simplify administration for plan sponsors, they can also provide a way for record keeping fees to be shifted from the plan sponsor to the participants. Thus, these arrangements raise the question of whether the fees are being used for the sole benefit of the participants or are benefiting the plan sponsor. Some plan sponsors choose a mutual fund provider based on who bears the cost of the fees. Testimony before the ERISA Advisory Council established that explicit charges in many plans have been shifted to participants (US DOL 2004b).

Brokerage commissions paid by plan participants out of their plan assets frequently include rebates from brokers to mutual funds that are used to reimburse the mutual funds for research (Schurr 2003). The excess expense used to pay for research is referred to as “soft dollars.” With “soft dollar” arrangements, mutual fund investment advisers use part of the brokerage commissions they pay to broker-dealers for executing trades to pay for research and other services.

“Soft dollar” fees are not included in the expense ratio that mutual funds report and are not disclosed to pension participants. They are the responsibility of the fund’s board of directors under current regulatory arrangements. These fees are generally not disclosed because they may be embedded within the net asset price of a purchase or sale. Because mutual funds do not disclose these costs, and the soft dollar costs are combined with transaction costs, this arrangement adds to the lack of transparency as to fees that participants pay (GAO 2003).

Kickbacks

Employers often hire pension consultants to help them pick the mutual funds to offer to their employees through their 401(k) plans. It is legal for pension consultants to charge a fee to the mutual funds they chose as well as to the employer. Consultants may also receive benefits in the form of having their expenses paid to attend conferences at resort locations. Consultants can gain business from employers by charging them low fees, with much of their compensation coming from mutual funds. However, questions arise about payments made by mutual fund companies to pension consultants that may influence the decisions made by pension consultants. These payments create a conflict of interest for the pension consultant, the conflict being the consultant’s desire to earn higher fees versus the consultant’s obligation to pick the best mutual fund, regardless of the fees the mutual fund pays the consultant.

The cost of those payments by mutual fund companies to consultants are ultimately borne by pension participants in the form of higher fees charged to pension participants by mutual funds. Until recently, the payments by mutual fund companies to pension consultants have not been disclosed to employers or pension participants. The higher fees could come in the form of higher brokerage commissions paid to a broker affiliated with the consultant, with "soft money" payments to the consultant (Wasik 2004).

Fee Disclosure: What's Wrong with Mutual Fund Disclosures

Some of the problems with mutual fund disclosures that are discussed in this section are confusing jargon, lack of standardization across companies, obscure footnotes, lack of fee disclosure on account statements, and misleading disclosures.

It is not surprising that a survey to assess individual knowledge about fees paid in 401(k) plans finds that over three-quarters of survey respondents did not know how much they paid in 401(k) fees (Table A5).[6]

Sources of Information About Fees

This section examines some examples of fees information provided from different sources, analyzing aspects of the disclosure that reduce the usefulness of the disclosure.

Enrollment Information

When workers enroll in a pension plan, they typically receive a packet that contains information about the plan. Depending on the number of options, the packet may contain relevant prospectuses. More frequently, participants do not receive a prospectus before they invest, though they generally receive summary information, including fee information. Prospectuses are often available online, but inertia prevents most participants from making the effort to obtain that information.

Expense Information Provided in Prospectuses

Typically, historical rate of return information on the fund is presented before information on fees. Choosing the fund with the lowest fees could be a mistake if that fund, for example, was highly conservative in its portfolio. However, it appears that the mistake of choosing inappropriately the fund with the lowest fees is rarely made.

Annual Statements of Account for Participants

Mutual funds and pension funds provide participants with annual statements. For example, Janus mutual fund company provides information about fees paid in dollars on

[6] Turner and Korczyk (2004). The survey was a randomized telephone survey. It asked respondents if they knew how much they were paying fees, and then asked a follow-up question of how much that was, either in dollars or as a percentage of assets.

its mutual funds, as required by a legal settlement, but it does several things that reduce the prominence of that information and obscure its usefulness. First, the disclosure will be described. Then its usefulness will be analyzed.

On the first page of the annual account summary it lists the additions and withdrawals from the account, which appear to fully account for all transactions that determine the difference between the beginning and end-of-year assets. It lists beginning-year value, additions, withdrawals, change in market value and end-of-year value. The end-of-year value is obtained by adding the additions, subtracting the withdrawals, and adding or subtracting capital gains or losses. Thus, it appears from this accounting, which exactly determines the end-of-year assets, that no fees are charged. Also listed on the first page are Transactions. The transactions also contain detail, but no indication that fees are charged to the account.

The second page contains information on the total portfolio value, which was already provided on the first page. It also contains some advertising about investing in an IRA and some information as to where you can obtain additional information. The third page contains no information relating specifically to your account. It contains information about Fund News and Janus Updates.

On the fourth page the fund annual expense ratio is provided as well as an estimate of how much in dollars you paid in expenses for the quarter. This page also shows how much you would pay going forward if you had invested $10,000 that grew at the rate of 5 per cent per year.

The disclosure of the fee information on the fourth page is not consistent with the accounting on the first page, which presents an apparently complete accounting from the beginning to the ending assets, with no indication that fees are paid or even how they could be paid within that accounting framework. The report does not indicate in the list of transactions that fees were withdrawn from the participant's account. Since an apparently complete accounting of transactions was provided on the first page, it is unclear how fees could be subtracted from the account.

The Janus disclosure uses the following strategies that make it less likely that the fees information will be read and understood.

1. It presents a "complete" accounting, showing no fees paid.
2. It presents a list of transactions, showing no fees being withdrawn
3. It presents information of limited interest before the fees information is presented.
4. It presents the fees information on the fourth page, requiring people to turn two pages to get to it, and providing a "framing" of the information that it is of lesser importance than the information that preceded it.
5. It presents the fees information for the quarter, even though it is an annual report.

Nontransparent Fee Disclosure

While investment fees are indicated in the prospectus, fees generally are not disclosed in the current financial repors of account statements available to pension participants in the United States. In prospectuses, quarterly statements, and annual statements, financial transactions are reported net of fees. Thus, when an apparently complete accounting is provided of the transactions, accounting for the difference between beginning and ending period assets, no fees are indicated. When fees are explicitly listed as a transaction on account statements, major components of fees, or all components of fees actually paid, are often excluded, and zero fees may be listed.

Though investment fees are far from transparent, administrative fees may be even more difficult for participants to discern. The plan sponsor may charge administrative fees against the participants' account balances, with that information never being disclosed on information that is automatically provided to participants.

Knowledge of Fees Paid

Little information is available about individual knowledge as to the fees they pay. In part to gain more information concerning individual knowledge concerning fees, in November and December 2003, the AARP Aging Indicator Survey was fielded for AARP by Southeastern Institute of Research, Inc. of Richmond, VA (Turner and Korczyk 2004). The study surveyed residents of the United States ages 25 or older, oversampling the population ages 50 and older. The survey sample was selected by a random digit dialing process to all households with telephone service living in the United States.

All participants holding stocks in a 401(k) plan or similar retirement plan, either directly or indirectly through mutual funds, were asked, "Do you know how much in fees you are paying for holding those stocks in that plan, either as a per cent of assets or as a total dollar amount?" For all age groups examined, at least 76 per cent of those holding stock in a 401(k) plan indicated that they did not know how much they paid in fees. Some of these responses, both positive and negative, doubtlessly reflect a lack of knowledge generally about the features of pension plans. Some respondents may have realized, however, that not all fees are disclosed and that even though they were aware of the disclosed fees they did not know all the fees they were paying.

While the main point of the survey results is the low level of knowledge about fees paid by pension participants, Table A5 also presents information on gender differences in knowledge as to fees. The results are consistent with other studies on worker knowledge as to financial aspects of investing (McCarthy and Turner 2000). Males self-report greater knowledge about investments than do females.

A follow-up question asked those respondents who answered that they did know how much they were paying, how much they paid, either as a percentage of their assets or in dollars. This follow-up suggests that the "yes" responses in the previous question overstated the extent of knowledge. More than one-third of those respondents either answered "don't know" or refused to answer on the follow-up question. Of those that provided a percentage or dollar figure, the survey was unable to verify the accuracy of the information they provided. Adjusting the original responses for this follow-up, more than 80 per cent of 401(k) participants would be categorized as not knowing how much they had paid in fees.

Conclusions

Fee disclosure to 401(k) participants is closer to what behavioral economics would prescribe for hiding fees information than it is to clear, informative disclosure. In several ways, the implicit, and sometimes explicit, message is that the participant paid no fees, or if paid, it was insignificant. Disclosing administrative and investment fees paid in dollars on the first page of an account statement would by a major step toward clear fee disclosure. A study by the U.S. General Accounting Office (GAO)[7] finds that while the total cost to the U.S. mutual fund industry of providing specific dollar fee disclosures might be significant, the cost on a per-investor basis could make such disclosure feasible.[iii] The GAO finds that improving disclosure would add $1.07 to the $184 in operating expense fees the average account is charged annually. If passed on to participants, the costs of improved disclosure would add six-tenths of 1 per cent to the operating fees charged each account.

[7] Currently this government agency is called the U.S. Government Accountability Office.

AUSTRALIA

Background

Australia has a mandatory employer-provided pension system known as the Superannuation Guarantee (SG or "super"). The system is referred to as superannuation because the plans typically pay benefits as a lump sum, rather than as an annuity. All workers are covered, except low-income workers, and workers under age 18 or over 75. Employers are required to contribute 9 per cent of workers' pay, up to a ceiling of earnings. A survey finds that 21 per cent of workers had a voluntary pension on top of their mandatory pension (Courier Mail 2006).

The mandatory employer-provided SG plans can be either defined benefit or defined contribution plans. However, because of greater ease for employers in complying with government regulations, most workers are covered by defined contribution plans. Those can be industry-wide or single employer plans. Because contributions are mandated by legislation and paid into funds administered and invested by the private sector, the government has introduced extensive safeguards to ensure that employees' pension entitlements are secure.

When the SG system was established, most employees could not choose how their funds were invested. The Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004 changed that. Employers are required to accept one change of fund by employees during a 12-month period, but are permitted to accept more frequent changes. The "Choice of Fund" legislation allows many employees to choose the superannuation fund their employer makes superannuation guarantee contributions into from 1 July 2005. Before then, the employer generally chose a single fund that was used by all the employer's workers.

Supporting worker choice, a subsequent change requires pension funds to provide on account statements information about administrative fees paid in Australian dollars. This type of fee disclosure is not found in most pension systems.

Regulatory Framework

All pension plans with five or more members are regulated by and must submit annual reports to the pension industry regulator, the Australian Prudential Regulatory Authority (APRA). Funds with fewer than five members with member trustees, called Self-Managed Superannuation Funds, are regulated by the Australian Taxation Office, while small funds with external approved trustees, called Small APRA Funds, are regulated by APRA. The Australian Securities and Investment Commission (ASIC) has responsibility for regulating fee disclosure.

The prescribed worked example concerning fees required in Product Disclosure Statements (PDSs) of superannuation funds does not include all fees and costs that may reduce a member's superannuation balance. One of these key fees or costs is the buy–sell spread. Calculations indicate that the average buy–sell spread is around 0.3 per cent of the amount transacted (ASIC 2006).

The buy-sell spread refers to a cost of making transactions in financial markets. However, at least one super fund in Australia has introduced a buy-sell spread for purchasing units in its funds (BT Financial Group 2007). This buy-sell spread is incorporated in the unit price. It is disclosed in the Product Disclosure Statement, but it is not disclosed in any account statements.

Regulation of Level and Types of Fees

The level and types of fees are not regulated.

Regulation of Fee Disclosure

In Australia, legislation requires the disclosure in dollar terms of administrative fees and charges by pension plans. The requirement applies to disclosures when establishing an account and to periodic account statements.

The Financial Services Reform Act (FSR) 2001 was intended to boost consumer confidence in the Australian superannuation and financial services industries by increasing disclosure requirements and enhancing the transparency and reliability of information made available (Cortese et al. 2005). This Act brought about more stringent disclosure rules aimed at making it easier for investors to understand financial products. The enhanced disclosure regime was designed to improve the quality and transparency of information made available to consumers.

Under this FSR Act, financial planners are required to provide investors with three documents before any advice is given. These documents include a financial services guide, which outlines the nature of the financial services being offered, how fees are charged, how the advisor or institution gets paid and how complaints can be resolved. Second, a statement of advice must be provided which details the recommendations made by the financial planner and explains the basis for the advice. It also details how the advisor is paid and any other interests, associations or relationships that could influence the advice provided. Finally, a product disclosure statement is issued once the client has invested in a financial product. This document details the mechanisms by which the investment operates, its fees and significant taxation implications, as well as the risks and benefits associated with the investment.

Starting 1 July 2005, enhanced fee disclosure regulations apply to Product Disclosure Statements. Each super fund is required to provide prospective participants a Product Disclosure Statement. The product disclosure statement shows all significant fees in a table and gives an example of the fees in dollars. The enhanced fee disclosure regulations state that when prospectively describing fees, fees should be expressed with minimum and maximum values rather than as a single figure when a range of fees and costs apply.

The fees must be listed in the Product Disclosure Statement workers receive before they participate. However, it can be difficult to compare fees because they are labeled differently by different providers, and they may be scattered throughout the Product Disclosure Statement, instead of being in a single place. To address these issues, ASIC has produced voluntary guidelines for service providers.

The dollar disclosure provisions require costs, fees, charges, expenses, benefits and interests to be stated as amounts in dollars. The provisions apply to:

1) Statements of Advice (SOAs);
2) Product Disclosure Statements (PDSs); and
3) periodic statements (including exit statements).

Under the ASIC guidelines, fees will be displayed in a separate section in the Product Disclosure Statement. The fee disclosure has three parts. First, all significant fees are shown in a single table. Second, an example indicates fees in dollars. Third, in addition, some more detailed information about the significant fees should be provided, including whether they include commissions to advisers and whether they are negotiable. All significant fees should be presented in an easy-to-understand, comparable format. The following key aspects should be covered:

1) what the fee is
2) the amount of the fee, in dollars preferably or if a percentage-based fee applies, examples of how this works in dollar terms will be provided outside the table and
3) how and when the fee is charged (for example, against assets, against contributions).

On periodic account statements participants receive, the following transactions are disclosed: contributions or withdrawals, insurance premium (if any), administrative fees, taxes and net investment earnings. Australian super funds typically outsource most functions, including investment management. Investment returns are reported to the funds net of investment-related fees.

Investment-related fees are only disclosed to participants in the Product Disclosure Statements, where the fee structure is disclosed. In one Product Disclosure Statement examined, which covered a number of funds, information on fees started on page 40 and continued to page 48. Because most of the expenses incurred by participants are investment-related, and those are not disclosed on account statements, the usefulness of the dollar disclosures on account statements is limited.

Super Switching Advice

ASIC provides guidance to financial providers who provide advice to individual clients as to whether they should switch superannuation funds. In this advice, ASIC counsels that the adviser should determine the extent to which the client is interested in minimizing fees. The guidance also requires the advice to consider the fees in the funds being compared.

Effectiveness of Fee Disclosures and Fee Regulations

The fees and charges applied to a superannuation or investment product must be disclosed under the requirements of the FSR Act. However, industry and consumer groups have suggested that, even with the revised fee disclosure model in place, consumers will continue to remain confused about how fees and charges may erode retirement savings in the long term.

The ability to change funds permits workers to change to less expensive funds. Initial estimates suggest that following the fee disclosure in dollars, 4 per cent of eligible workers staying with the same employer changed funds during the first six months that this was allowed. Surveys indicate that the majority of participants did not change funds because they were satisfied with their fund, rather than that they were unaware of the option to change (International Reform Monitor 2007).

While the disclosure of administrative fees in dollars is a major step forward, by itself it probably accomplishes little because investment expenses are not disclosed.

CANADA

Background

Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs) are the two main vehicles for private pensions and personal retirement savings in Canada. RPPs are occupational pensions voluntarily established by employers. They are predominantly defined benefit, but defined contribution plans have been playing an increasingly important role. RRSPs are personally managed, individual savings plans.

Regulatory Framework

There are substantial differences between the regulatory framework for defined contribution pensions and for group RRSPs and private RRSPs. Because defined contribution plans have played a minor role in the pension system until recently, their regulation has received less attention than for defined benefit plans. In addition, RRSPs are subject to less regulatory oversight than defined contribution RPPs. Fees have received little regulatory attention.

The regulatory framework in Canada is divided among different government entities. Pension policy relating to the tax policy toward pensions and the regulation of pensions in some nationwide industries is determined at the national level. The Office of the Superintendent of Financial Institutions (OSFI) is an independent agency of the Government of Canada reporting to the Minister of Finance. It is the primary regulator of federally-regulated banks, insurance companies, and pension plans.

For constitutional reasons, pension policy is determined partly at the provincial level. Each province has its own pension benefits law regulating the pensions within its jurisdiction that do not come under federal regulation. Thus the legal and regulatory conditions differ across the provinces.

Provincial and territorial legislation, rather than national legislation, govern the mutual fund industry, regulating the underwriting, distribution and sale of securities. A primary objective of this legislation is full disclosure for all securities, including mutual funds. Disclosure requirements are usually met by providing a prospectus issued by the company and accepted for filing by the regulatory body. Securities legislation also requires the on-going disclosure of information by companies, such as regularly issuing financial statements. Most provinces and territories require that this information be sent directly to individuals purchasing units in mutual funds and to other shareholders.

While each province and territory has its own legislation, regulators meet regularly to coordinate regulation of the securities industry and markets. The number of national policies issued by the Canadian Securities Administrators has increased in an attempt to create a consistent set of regulations across Canada. Nevertheless, mutual fund companies must file regulatory documents with the relevant provincial and territorial securities authorities, which raises their costs compared to a system with a single national regulator.

The Investment Industry Regulatory Organization of Canada (IIROC), the Mutual Fund Dealers Association of Canada (MFDA), and the stock exchanges self regulate. The IROC regulates its own members who sell securities, including mutual funds, while the MFDA regulates the distribution side of the mutual fund industry. Self-regulatory organizations have the power to admit members and perform compliance reviews. For example, investment advisors selling mutual funds to the public must register with the IIROC or the MFDA, and their staff must complete industry-sponsored training programs before being permitted to sell mutual funds and other securities. The self-regulatory organizations also have the power to establish and enforce industry regulations to protect consumers and to ensure companies conduct their business in a fair and ethical manner.

The Joint Forum of Financial Market Regulators was founded in 1999 by the Canadian Council of Insurance Regulators (CCIR), the Canadian Securities Administrators (CSA), and the Canadian Association of Pension Supervisory Authorities (CAPSA). It also includes representation from the Canadian Insurance Services Regulatory Organizations (CISRO). It was established as a mechanism through which pension, securities, and insurance regulators could co-ordinate, harmonize and streamline the regulation of financial products and services.

Level of Fees

Mutual fund fees in Canada are high by international standards. The largest mutual fund, Investors Dividend Fund, charges a management expense ratio of 2.71 per cent (Chevreau 2007). An international study finds average fees in Canada were higher than in other countries (Table A1).

Regulation of Level and Types of Fees

The level of fees is not regulated. The Joint Forum of Financial Market Regulators (2005) makes the general statement that plan sponsors are responsible for judging the reasonableness of fees charged by plan service providers. The Joint Forum of Financial Market Regulators (2004) specifically lists as allowable fees for transfers between funds exceeding a set number of transfers in a year. The government does not regulate types of fees.

Effectiveness of Fee Disclosures and Fee Regulations

Mutual funds purchased through defined contribution pension plans in Canada are not sold by prospectus. However, prospectuses are used for investments in individual account plans, they are a major source of information for Canadian investors, and they could be used to provide greater fee disclosure to pension participants in Canada.

The investment expense ratio is known in Canada as the management advisory fee (MAF). The management expense ratio (MER) incorporates custodial, bookkeeping, fund transaction and other administrative expenses in addition to the costs of managing the investment portfolio.

Disclosure in the mutual fund industry in Canada is mandated under various Canadian Securities Administrators National Instruments (NIs): NI 81-101, 81-102 and NI 81-106, which have been adopted by each province. They specify the standard way fees must be disclosed to investors and wording that sales communications must substantially reflect regarding the fees.

Aspects of the fee disclosures in mutual fund prospectuses do not contribute to clarity as to the level of fees paid by participants. Technical distinctions can be used to create confusion for unsophisticated participants. When prospectuses list “Fees and expenses payable by the funds” and then separately list “Fees payable directly by you,” the language could easily be misleading to unsophisticated investors. Reading only the headings, it would appear that some fees are not payable by you and some are. In fact, all fees are “payable by you” either directly or indirectly as charges to your account.

This distinction between fees charged directly to you and fees charged to your account impedes clear understanding of fee disclosures by pension participants who are unsophisticated investors. The explanation that the participant does not have to pay the fees directly, but the fees do reduce the value of his account is not the clearest way to explain that the fees are being charged against the participant’s account.

One of the ways that fee disclosures are unclear, exemplified by the above case, is that headings and supporting text are often not consistent. In the example above, the headings suggest that some fees are not paid by the participant, while the supporting text suggests otherwise. In other cases, the headings suggest the participant pays fees, while the supporting text suggests otherwise.

The statement appearing in a prospectus available on line that “There are fees and expenses payable by the underlying funds in addition to the fees and expenses paid by the Portfolio” provides no useful information to a pension participant who is an unsophisticated investor.

Jargon impedes understanding. The term “trailer” fees is not clear without specialized knowledge. It corresponds somewhat to 12b-1 fees in the United States, and refers to ongoing fees paid to dealers. The Joint Forum of Financial Market Regulators (2004) has recommended that pension participants be given glossaries of financial market terms to deal with the problem of jargon.

SEI Canada surveyed defined contribution plan participants in 2004. It finds that 52 per cent made no use of financial education and decision-making tools provided by plan sponsors (Cohen and Fitzgerald 2007).

CHILE

Background

In 1981, Chile replaced its traditional defined benefit social security program with a mandatory individual account system. In the mandatory individual account system, a 10 per cent contribution rate by workers is levied on wages, and then a percentage fee is charged on top of that plus a charge for term disability insurance and life insurance. The Chilean private accounts completely replace the social security system that existed before the private account system was started. In Chile, each month every employer must send a payment to each of the pension fund companies in which its employees have invested—in 2008, six companies are operating.

Regulatory Framework

The Superintendencia de AFP (Administradoras de Fondos de Pensiones) is the government agency that regulates the pension funds, called AFPs.

Level of Fees

Pension funds in Chile levy an administrative fee as a percentage of contributions. Some also have levied a fixed fee, but fixed fees have been ended by legislation (SAFP 2008*)*.

The percentage fees ranged from 1.41 per cent to 2.99 per cent of wages in March 2008. They also include a charge for disability benefits and life insurance, which is mandatory for men under age 65 and women under age 60, but is not mandatory above those ages. The fees for those not eligible for disability benefits and life insurance ranged from 1.18 per cent to 2.35 per cent. Those fees represent the administrative fees for people not charged for disability and life insurance but are not a precise measure of the administrative fees charged those eligible for disability and life insurance because the government does not require that the fees charged the two groups be the same.

Administrative costs have declined over time, as measured as a percentage of assets. The decline has occurred at least in part because the level of total assets invested by pension funds has increased, and as the level of average account balances has increased. The administrative costs of the pension fund companies in the Chilean system in 1998 averaged 1.4 per cent of account balances (James, Smalhout, and Vittas 2001). Accumulated over the working life, 28 to 33 per cent of the contributions of the average Chilean worker who retired in 2000 went to fees (Gill, Packard, and Yermo 2005). These statistics on fees, however, do not include the cost of annuitizing benefits or of other forms of benefit payout and do not include the trading costs of the AFPS in financial markets.

Regulation of Level of Fees

Fee levels for pension fund investment management and administration are not regulated but are determined by market forces. All participants in an AFP must be charged the same percentage fee, rather than, for example, a lower fee being charged for participants with large account balances. In 2004, a cap was legislated on commissions for converting account balances to annuities. The cap is 2.5 per cent of the value of the annuity (US Social Security Administration 2004). While other fees are not regulated explicitly, they are subject to close scrutiny by the government and politicians, with threats of regulation if fees are set too high. This oversight scrutiny provides a de facto cap on fees.

Starting in 2008, all the AFPs enter into a bidding process to determine which one charges the lowest fee. The winner of that process is advertised by the government, providing participants benchmarking information as to what the lowest fee charged is. In addition, and more importantly, all new entrants will be automatically enrolled in that AFP.

Regulation of Types of Fees

While most other countries rely on charges levied as a percentage of assets, Chile has banned those charges and relies primarily on charges on contributions. Chile banned charges on assets because of the effect of asset-based charges on the accounts of persons who had intermittent employment. The charges continued during periods while they were not contributing, resulting in some cases in declining account balances during those periods.

In addition, AFPs are not permitted to charge an exit fee if the participant wishes to switch accounts. That fee is not permitted because it could hinder competition between funds (Edwards 1998). Until October 2008, AFPs have been able to levy a fixed fee on monthly contributions. A recent reform ends the fixed fee, which added an element of regressivity in the fee structure.

The AFPs are allowed to charge the following fees: a proportional fee on contributions, a fee for opening a new account, a fee for managing programmed withdrawals during retirement, and a fee for managing voluntary contributions made in addition to mandatory contributions.

Regulation of Fee Disclosure

The fees charged pension participants are combined with mandatory insurance premiums and are never separately disclosed. It has not been possible to obtain exact information on fees charged in percentage or in monetary terms. Each AFP separately contracts with an insurance company, so the insurance premiums differ across AFPs.

Starting in October 2008, the mandatory insurance premiums will be separated from the fee, so it will be clear for the first time what the fee charged by each AFP is.

Every four months, each participant receives an account statement. As an attachment to those account statements, they also receive a chart indicating the fees charged by each AFP. That chart is available at the SAFP website (http://www.safp.cl/safpstats/stats/inf_afiliados/calcos.html). It is also available on the websites of the AFPs.

Competition Based on Fees

In Chile the level of fees charged is not a key factor in choosing between different funds. One study finds little price sensitivity among pension participants with respect to the level of fees (Reyes and Castro 2007). Funds do not compete on the basis of fees, with no funds advertising that they charge low fees. Instead, competition has been based on marketing and on inducements in the form of small gifts to entice people to change funds. By offering gifts to selected customers, the AFPs are able to some extent to price discriminate to attract wealthier clients with larger account balances.

Effectiveness of Fee Disclosures and Fee Regulations

A survey in 2002 of 17,000 participants finds that 95 per cent did not know how much fund managers had charged in fees (Superintendencia de AFPs 2003). More recent research has confirmed that most workers do not know how much they are paying in fees (Arenas et al. 2006).

SWEDEN

Background

A major reform passed in 1994 changed the public Social Security system from a traditional defined benefit plan to a hybrid plan with defined benefit and defined contribution features. This plan is called a notional defined contribution (NDC) plan. It is financed on a pay-as-you-go basis. It provides each participant an individual account, but the plan is notional because each individual's account is a bookkeeping entry rather than a funded account.

Sweden has also instituted a mandatory funded individual account system. That system incorporates lessons learned from the experiences of Chile and other countries, particularly in ways to reduce administrative costs. In addition, as a safety net, a means-tested guarantee pension provides a minimum pension. The means test is against income from the mandatory earnings-related pension, and thus it is a "pension-tested" benefit.

The mandatory funded pensions provide individual accounts based on contributions of 2.5 per cent of the pension wage base. Workers choose from about 800 investment options or, if they make no choice, their money is placed in a government-managed default fund. The money in these accounts earns investment returns.

Regulatory Framework

The Premiepensionsmyndigheten (PPM), a government agency, administers the individual accounts. The PPM's role is a new one to the Swedish system – an active agency approach to a nationwide system of small accounts with a wide variety of investment choices. As such, it is on the frontlines of setting, processing, and tabulating fees for individual accounts, as well as financial education on fees for account holders.

The administration of the Swedish mandatory private accounts differs from most other private account systems. Sweden has reduced costs by creating a central government agency to administer the accounts. The clearinghouse collects the monthly payments from employers. Rather than making monthly deposits of contributions to private accounts, the clearinghouse invests the deposits in government bonds and makes a single annual deposit (including interest) approximately six months following the end of the calendar year. The clearinghouse handles the record keeping for the individual accounts.

Level of Fees

The total pension fees in Sweden averaged 0.95 per cent of assets in 2000, the first year of the system (Palmer 2001). Of the total fee, the Premium Pension Agency (PPM) charges a fixed annual fee that initially was 0.3 per cent of the account balance, but that has fallen over time to 0.13 per cent in 2007. That fee is collected by each fund from the assets that it manages and transmitted to the Premium Pension Authority to cover its administrative expenses. The clearinghouse is intended to be self-financing over the long-run but initially had to borrow from the government because of high start-up expenses. The Premium Pension Authority has an institutionalized goal to reduce charges down to 0.1 per cent within 15 years.

Each mutual fund charges a management fee, which it deducts from the assets it manages and uses for its own expenses. In 2001, the fee charged by the default fund was 0.48 per cent of assets, compared to 0.72 per cent of assets on average for the privately managed funds. If workers' choices were limited in Sweden to low-cost mutual funds, the total cost to workers would be approximately 0.55 per cent of assets per year (Palmer 2001). In 2003, the average fund fee after rebates was 0.43 per cent of assets, with the fixed administrative fee by the PPM of 0.3 per cent, resulting in a total cost of 0.73 per cent of assets for the average participant (Sundén 2008). Fees will probably decline as more experience is gained with the system and the asset base grows.

The funds charge fees ranging from 0.2 per cent to 3.97 per cent of the worker's account balance in the fund. It should be noted that 3.97 per cent is a very high level of fees. A majority of funds, however, charge fees of less than 1.24 per cent. By comparison, fees charged by T. Rowe Price, a large U.S. mutual fund company, generally range from 0.35 to 1.5 per cent of assets. Participants generally have picked low-fee funds; 48 per cent of the money invested in the system was invested in funds with fees ranging from 0.25 per cent to 0.49 per cent (Palmer 2001). This outcome suggests that participants are sensitive to the level of fees when choosing funds.

The default fund (Seventh AP Fund) also places a priority on low management fees. The money management fee for the default fund was only 0.16 per cent after the rebate in 2003 (Sundén 2008). In 2004, less than 10 per cent of new participants made an active investment choice, so the large majority were placed in the default fund (PPM 2008).

Regulation of Level of Fees

Sweden has a variable formula it uses to regulate the maximum charges allowed by a mutual fund. The formula used to determine charges depends on the price charged for voluntary savings in the mutual fund, the value of the mandatory contributions attracted and the total value of mandatory pension assets managed (Bateman 2001). Regulations on fees were introduced to create a system with a wide range of funds but that is cost effective. The result is that total charges for a large fund must not exceed around 0.75 per cent, about half the charges levied in the mutual fund market. The fee structure is designed in part to discourage participants from investing in funds with high fees.

Fund companies that seek to participate in the Swedish system must sign a contract with PPM that governs reporting requirements and the fee structures, including agreeing to fee rebates to the PPM, as well as agree to allow contributors the right to change funds without limit and without charges. Funds must charge the same management fees in the PPM system as they charge in the private market, prior to the rebate. Each fund manager can have no more than 25 registered funds at any one time. Several fund managers who together form a single management group can have a combined total of 50 registered funds (PPM 2008). Morningstar handles the collection, processing and quality audit. Fund managers provide information on fund value, rate of turnover, and total expense share. Morningstar monitors the information continuously for control and verification (PPM 2008).

The fund companies' contracts with the PPM stipulate that part of the fee the mutual funds receive must be rebated to the PPM. The PPM passes on to the participants all the savings from the rebate. The rebate is possible because the PPM performs most of the administrative functions for the accounts, so the administrative cost for the fund managers is lower in the Premium Pension system than in private financial markets. For example, rather than interacting with numerous individual investors, the funds have a single transaction per day with the PPM, which reflects the net of all the buying and selling transactions with respect to the fund.

The fee rebate system has drawbacks. It is very complicated, with 12 different parameters determining the charge ceiling. It is complex and non-transparent, as the following explanation indicates. The size of the rebate depends on the fund company's gross fee and the size of PPM’s investment in the fund. Funds with high gross fees and large PPM investments pay a higher rebate. The individual participant’s rebate consists of two parts: an individual share and a general share. The individual share depends on the fees charged by the funds in which the individual has invested and is given for funds whose usual fee exceeds 0.4 per cent. The rebate is 25 per cent of the difference between the gross fee and 0.4 per cent. Once the individual rebates have been distributed, the remaining rebate is distributed equally among all participants based on account size. Since the remaining rebate is tied to the participants’ account balances and not to fees paid, it returns a higher percentage of fees to workers choosing low-fee funds.

Early in the development of the new pension system, the PPM and its fee structure came under criticism for being too costly and complex (EPIN 2007). In April 2007, a new fee structure was introduced to reduce costs for the participants. The fee structure involved greater rebates to participants, resulting in lower net fees for fund providers. Though many were not affected, JP Morgan cut 24 of its listed funds (EPIN 2008).

Regulation of Types of Fees

No fees are charged when participants change investments to not discourage workers from switching funds. The account holder can make unlimited changes without extra charge. No fees are charged on benefit payments. Flat amount fees cannot be charged to not disadvantage low-wage workers with small accounts. The mutual fund fee covers all the expenses of the fund except transactions costs arising from the purchase and sale of securities. Those fees are incorporated in the net rate of return the workers receive on their account balances. Fees are only charged as a percentage of assets.

Regulation of Fee Disclosure

Individuals participating in the system receive an annual statement indicating the amount in their accounts in the Premium Pension. In Sweden, every year all participants receive a booklet providing information about the fund options, including the fees charged by each fund. The most relied upon set of personal information provided by PPM is the "Orange Envelope." On the inside pages is the account balance, a line as to how much is paid in administrative costs and fund fees, which are lumped together as total fees paid. On another page is the participant's asset allocation, with fees paid for separate funds. While the exact calculation of that amount has varied since the start of the system, as of 2008 the disclosure of fees paid included the administrative fee paid to the PPM plus the investment fees paid to the mutual funds less the rebates of fees from the mutual funds. In its mandatory notional defined contribution system, fees are disclosed in Swedish kronas on individual account statements (Turner 2006).

Both PPM and the Social Insurance Board have a joint agreement to stress educating the public on the public pension system and how choices, including fees, affect their individual accounts. These two organizations share the goal of standardizing the language of fees and investments through pension education.

Competition Based on Fees

The PPM has attempted to encourage competition based on fees through the way it structures fee rebates. Competition across funds is also used as a mechanism to limit the fees charged by different funds, which are listed in the booklet provided all workers. Some investment funds try to attract participants by advertising their low fees. This fee structure favors low-cost funds; workers choosing those funds receive a larger rebate in comparison to the fees they paid than workers choosing funds with high fees. Thus, while fee level differences across funds provide incentives for workers to choose low-fee providers, incentives to do so are increased through the rebates. The rebate system discourages the participation of high cost funds that invest heavily in advertising.

Effectiveness of Fee Disclosures and Fee Regulations

The structure of fees that participants pay is complex, which may result in participants not understanding the way fees are determined. Survey results indicate some participants may have been confused about the investment process-- while 18 per cent of new participants in 2001 made a choice, 34 per cent thought they had. Also, a number of workers chose the default fund because they felt it was safer than other options, which is an inaccurate assessment of its risk (Betson 2001). A survey indicated that the majority of people who made an active choice could not remember which funds they had invested in. Of those who made a choice, 73 per cent could not name all the funds they had invested in and 41 per cent could not name any (Jarvenpaa 2001).

The government has made an effort to make participants aware of the importance of considering fees when they make their investment decisions. A high percentage of

Swedes choose the default fund. It is particularly likely that those participants are unaware of the fees they are paying.

Conclusions

Attention to making fees transparent to the participant, and encompassing them in the PPM's instructions for investment selection, makes fees endemic to pension information from the Swedish government. It is a major part of their financial education, and always present in official information and communications. Important as well for individuals, built into the rebate structure is the rewarding of individuals who choose low-fee funds. While the process of setting fees and calculating rebates is complex and not transparent. Fees in comparison to other countries continue to trend low.

UNITED KINGDOM

Background

While the individual account pension systems in Australia, Chile and Sweden are mandatory, the system in the United Kingdom is voluntary and therefore more complex, leading to higher administrative costs. In the UK, workers can voluntarily withdraw from part of social security and have part of their contributions diverted into private carve-out accounts. The government collects all contributions and distributes them to the pension fund providers chosen by the participants. The record keeping for the accounts is decentralized, being maintained by each pension fund provider.

Workers may be covered by occupational pensions provided by their employers. In recent years, defined benefit plans have declined rapidly, with many existing plans not accepting new members. Defined contribution plan membership has grown. Workers can establish individual pensions, called stakeholder pensions or personal pensions. Stakeholder pensions have maximum contribution limits that make them most appealing to lower- and middle-income workers.

Regulatory Framework

In the UK, the entities with primary regulatory responsibility for pensions are the Pensions Regulator (TPR) and the Financial Services Authority (FSA). Both of these institutions were formed after the pension misselling scandal in the 1990s. They have entered into a detailed memorandum of understanding that allocates authority between them. The memorandum divides authority according to the entities subject to oversight.

In general, TPR has responsibility for oversight of and providing advice to employers and trustees of work-based pension plans. It is thus responsible for regulating trust-based pension plans. TPR is a public body accountable to the Department for Work and Pensions (DWP). Although DWP, not TPR, develops pension policy and law in the UK, TPR is widely-recognized as a regulatory body. TPR has indicated that "unduly high charges" is one of its areas of concern with respect to regulating defined contribution pensions (The Pensions Regulator 2008).

The establishment of the FSA as a super-regulator included the merger of ten different agencies. The FSA regulates the financial services industry. In the pension area, it is responsible for regulating contract-based pension plans. The FSA regulates the financial service providers that are involved with the marketing, sale and provision of personal pensions and annuities. The FSA also has responsibility for improving investor knowledge and understanding of financial products and markets. In most part the UK has allocated authority for fee issues to the FSA (Muir 2007).

The FSA and the TPR do not assist participants with individual complaints. In the UK, three different ombudsman services and the Pensions Advisory Service share responsibility for assisting individuals with pension-related questions, disputes and compensatory rights. The US, in contrast, leaves dispute resolution primarily to its federal court system.

Level of Fees

In 1998, the fees charged workers by pension fund providers averaged 3.2 per cent of assets per year for individuals in plans for 10 years and 1.7 per cent per year for those in plans for 25 years, with the rate declining for longer periods due to the front loading of fees (Blake and Board 2000).

Regulation of Level of Fees

The level of fees is not regulated except for stakeholder pensions. High fees charged to participants in individual accounts have been an issue in the United Kingdom. The policy response has been to institute stakeholder pensions. When first offered in 2001, stakeholder scheme fees were capped at 1.0 per cent per year. Effective in 2005, the cap was increased to 1.5 per cent a year for the first 10 years of a customer account. Thereafter the fee cap drops back to 1.0 per cent (Byrne et al. 2007).

Regulation of Types of Fees

The types of fees charged are not regulated except for stakeholder pensions. Stakeholder pensions cannot charge sales fees. Providers are not permitted to charge a fee for switching to a different service provider. Stakeholder pensions cannot have charges for opening or closing an account. The only permissible charge during the accumulation phase is the management fee. Stakeholder pensions are also permitted charges with respect to expenses related to benefit payment or annuitization.

By contrast, the government does not regulate the types of charges levied by other types of defined contribution pensions. Regulation of types of fees facilitates comparisons across different service providers by standardizing fee structures.

Regulation of Fee Disclosure

The regulations concerning stakeholder pensions specify that the annual report to the participant must disclose “any other amount deducted from the member's account, the nature of the deduction and the date on which it was made” (The Stakeholder Pension Scheme Regulations 2000). This requirement could be interpreted to indicate that fees paid should be disclosed in pounds. However, it has been interpreted to only require disclosure of fees levied for a particular activity, such as changing investments.

Since April 2003, defined contribution plans have been required to provide an annual illustration of the potential value of members’ projected pension benefits at retirement. These actuarial calculations are known as Statutory Money Purchase Illustrations (SMPIs). They are a step toward greater disclosure of information to participants.

Fee Disclosure

Fees are communicated to participants when they join a plan and may be mentioned in newsletters (The Pensions Regulator 2008). Fees generally are not disclosed on account statements that participants receive.

Fee Disclosure Over the Internet

The Internet is increasingly becoming a source of information about fees charged to pension participants. The Financial Services Authority provides on its website a calculator that compares the charges of different pension plan providers for stakeholder pensions and personal pensions. To use the calculator, the person needs to enter in the age when he starts contributing, how much he will contribute per month (a single number), and when he expects to retire. The program provides fees paid, measured as the amount by which the account balance is reduced at retirement due to the payment of fees over the accumulation period, assuming a constant 7 per cent rate of return per year.

Effectiveness of Fee Disclosures and Fee Regulations

Most defined contribution participants in the UK appear to be disengaged from the investment process, 94 per cent taking the default option when one is offered (Byrne et al. 2007). This finding suggests that they are not well informed about the investment options, probably do not know about the fees they are paying, and passively accept the default option. For participants who are not making active investment decisions, issues of fee disclosure are perhaps irrelevant. However, knowledge about fees in alternative investments might cause participants to take a more active role.

The UK government characterizes stakeholder pensions as low-fee pensions, but at least in the international context, that characterization does not appear to be accurate. They are several times more expensive than low-fee pensions in the US. Not all providers, however, levy the maximum charge. Some providers charge lower fees for pensions provided to a group, such as employees at a single firm (Steventon and Sanchez 2007).

A recent study of fees charged by stakeholder plan default funds implies that the legal caps in some cases result in higher fees than otherwise would be charged. Based on fee data for other plans, it would be expected that the approximately fifty per cent of default funds which utilize a passive investment style would have lower fees than the default funds that consist of actively managed funds. The actual modal investment fee, however, is 1.0 per cent across both active and passive default funds. Effectively, it appears that the fee cap has been established as a floor as well as a ceiling for stakeholder scheme fees. However, the mean charge of passive default funds is 20 basis points lower than the mean for active default funds, which is somewhat more in accordance with expectations (Byrne et al. 2007).

The Financial Services Authority website can be used to compare the fees in stakeholder and non-stakeholder pensions. It indicates that stakeholder pensions lack a clear advantage over the non-stakeholder pensions in terms of lower fees. The stakeholder pensions were not among the most expensive, but neither were they among the least expensive when comparing over a 25 year period.

The Financial Services Authority website also shows what the level of fees would be if the participant stopped contributing after three years. That level of charges for a particular example ranged from £64 to £1,518, with the stakeholder pensions being the least expensive pensions over the three-year period. Thus, the table indicates that the choice of funds with respect to level of charges depends critically on how long the participant anticipates contributing to the fund. Over the long-term, stakeholder pensions are not the least expensive pensions, but over the short term they are.

For non-stakeholder pensions, charges are typically incorporated in the unit price of an investment and are not separately disclosed. It is commonly thought unlikely that most participants are either aware of or understand the fees they pay. This is particularly likely when participants take the default investment (The Pensions Regulator 2008).

The Pensions Regulator has expressed the possible position that one-to-one advice would be necessary to improve the understanding by participants of fees, though more clearly presented documentation might also help (The Pensions Regulator 2008). A recent survey of pension professionals indicated that what most defined contribution participants want is not the disclosure of more information, but rather to have an expert make the financial decisions for them. The main problem with this finding is that most pension experts do not want that responsibility for fear of legal liability (Byrne et al. 2007).

Appendix Tables

Table A1. Mutual Fund Expenses, Selected Countries, 2002 (per cent of assets)			
Country	Management expenses	Total expense ratio	Total shareholder costs
Australia	1.09	1.17	1.41
Canada	1.96	2.56	3.00
Sweden	1.32	1.37	1.51
United Kingdom	1.07	1.18	2.28
United States	0.62	1.11	1.53
Note: Management expenses include charges levied each year for management services. The total expense ratio includes all annual expenses charged against account balances, including investment expenses. Total shareholder costs include all annual expenses plus an annuitized form of loads assuming a five year holding period. Source: Khorana et al. 2007.			

Table A2. Who Pays 401(k) Administrative and Record Keeping Fees, 2005	
Who Pays	Per cent
Employer	37
Employee	55
Through charge against assets	43
Through direct charge to participant	12
Directly paid by employee and employer	4
Other	4
Source: Investment Company Institute (2006)	

Table A3. Disclosure of Fees by Employers to Participants		
Fee disclosure communication method	Per cent of plans	
	Administrative fees	Investment management fees
Only upon participants' request	38%	30%
Disclose periodically by written communication	26%	23%
With participant account statements	28%	33%
Other (e.g., prospectus, summary annual report, summary plan document)	8%	14%
Source: Hewitt Associates (2005)		

Table A4. Sample Brokerage Commission Disclosures in Three Mutual Fund Families
Item and Fund Family
#1
Total brokerage commissions paid
As % of net average assets
Brokerage commissions paid to firms providing research services
Amount of brokerage transactions involved
#2
Total brokerage commissions paid
Percentage of brokerage commissions paid to firms providing research, statistical, or other services

#3
Total brokerage commissions paid
Management and administrative expenses as % of fund assets
Marketing and distribution expenses as % of fund assets
Expenses incurred for investment advisory services
Source: *Statements of Additional Information.*

Table A5. Knowledge of investment fees paid by participants in 401(k) plans
(Per cent, except for Unweighted base)

Response	Yes	No	Don't know	Refused	Unweighted base
Age 25-49	17	58	24	1	139
Age 50+	20	59	21	0	342
Age 50-64	18	62	20	0	257
Age 65+	25	53	22	0	85
Male	26	53	21	0	138
Female	14	65	21	0	204

Note: No results for groups with an unweighted base of less than 30 are reported. The total sample size is 1,207 persons.

Source: Turner and Korczyk 2004.

[i] We have received helpful comments from Keith Ambachtsheer, Philip Diamond, Paul Halpern, Gonzalo Reyes, Annika Sundén, Wilson Sy, Salvador Valdés-Prieto and Elizabeth Woodman.

[ii] The effect is smaller for accounts where contributions are made every year.
[iii] U.S. General Accounting Office (GAO) 2004.